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- Canada as a Challenge to the Accounting Profession By Walter J. Macdonald
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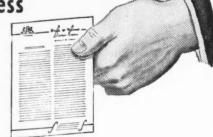
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VOLUME 63	DECEMBER 1953	NUM	IBER 6
Christmas Greetings from	the President		261
Comment and Opinion: Ta	ax Appeals		262
The Audit of Management	Methods and System	s E. D. MacPhee	264
Canada as a Challenge to Profession		alter J. Macdonald	271
Some Notes on Witnessing	Pay-Offs	. George C. Watt	279
Notes on the Development Profession (Part II)	of the Accountancy	J. E. Smyth	283
The Purpose of Profession	al Auditing	Alfred F. Gosling	293
A Recent Book			298
Is the Current Student Trai Appropriate?	ning Course	E. W. Thompson	299
A Letter from a Reader			303
Obituaries			304
Professional Notes			305
News of Our Members			307
Accounting Research		Gertrude Mulcahy	308
The Students' Department		J. E. Smyth	315
Index to Volume 63			i

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SWEETNESS

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By Jay Vee

"CHRISTMAS comes but once a year" and each year it poses to all working Canadians the same question: "How many days off will we be getting this time?"

Some harassed managers are still embroiled in making a decision concerning Christmas 1953 which falls on a Friday, but we have already overheard at least two groups of far-sighted employees discussing the various possibilities for Christmas 1954 which will inconveniently fall on Saturday. That means that Boxing Day will be on Sunday, but Sunday is already a holiday. Now, will the employer take the opportunity to get some of his own back in compensation for the Thursday Christmas of 1952, or will he be caught in a magnanimous mood and celebrate Boxing Day on Monday, December 27?

We always contrast this type of speculation with the Table of Movable Feasts to be found in the front of most prayer books. By quick perusal of the table you can tell when Septuagesima Sunday, Ash Wednesday, and Easter will fall every year for several decades. When our sixth birthday came on Good Friday, a grown-up friend told us that we would not have another Good Friday birthday until after the year 2000 A.D. With considerable stubbornness we struggled through the Table of Movable Feasts only to find that he was quite right.

It looks as though someone should make up a similar chart for the Christmas break. At the back of the "Employees Manual" Schedule A might give the weekday on which December 25 falls and the bonus days off, if any. Thus at one glance the executive vice-president or the office boy will know that in 1955 Christmas Day will be on a Monday and he is safe in planning a four-day visit with Aunt Euphrasia in Timmins.

But whether our readers are raising whoopee with Aunt Euphrasia in Timmins or spending the days with their own families at home, we wish each and every one all the blessings of the Christmas season.

Subject to the Foregoing . . .

A CLIENT of Mr. Ellis A. Clarke, C.A. (Ont.), passed on to him the following piece of poetry. Mr. Clarke has been marking the first Auditing lesson in the first year course in which the student is asked to discuss the auditor's report as to qualifications in scope and opinion. Since a large number of students did not seem to know what a qualification is, he feels that these lines may answer the question for them!

AN AUDITOR'S CERTIFICATE

We have studied the balance sheet and say in our report

That the cash is overstated, the cashier being short;

That the customers' receivables are very much past due;

And if there are some good ones, they are very, very few;

That the inventories are out of date and practically junk,

And the method of their pricing is very largely bunk;

That according to our figures, the undertaking's wrecked.

But subject to these comments, the balance sheet's correct.

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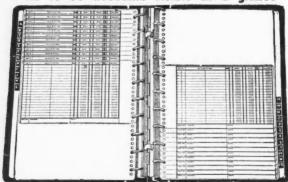
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VOLUME 63

DECEMBER 1953

NUMBER 6

The President, the Executive, and the Council of

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for a very Merry Christmas

and

a most prosperous Rew Dear



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l'Institut Canadien des Comptables Agreés bous offrent leurs meilleurs boeux pour un Jopeux Noël

et

pour une Bonne et Beureuse Annee

Walter Macdonald President

COMMENT AND OPINION

Tax Appeals

IN each of the years since 1948 there have been more appeals by taxpayers from income tax assessments than in all of the years prior to 1949 from the beginning of income tax in Canada. All, or virtually all, of this growth stems directly from the institution of the Income Tax Appeal Board, because there has been little or no increase in the number of taxation appeals to the Exchequer Court of Canada and to the Supreme Court of Canada. Inasmuch as far more taxpayers lose than win in the Income Tax Appeal Board and few losers pursue their grievance further, the obvious conclusion is that what the dissatisfied taxpayer wanted - and what he got - was the opportunity to have his day in court rather than victory at all costs.

Under our system, an assessment to tax is deemed to be purely a private matter between the assessing authority and the taxpayer who is assessed, and while the latter has his right of access to the Courts it is for him to assert it, and no-one else, however interested in the matter, can do so in his place. It follows that if enough taxpayers with grievances do not seek their remedies the interpretation of the tax law will continue to rest very largely with the tax administration, whose natural bent is, for obvious reasons, somewhat divergent from that of most taxpayers.

The interpretation of an Act of Parliament is and always has been ex-

clusively a matter for the Courts, and the final arbiter of its meaning is the court of final resort, in this country the Supreme Court of Canada. It is only when the Supreme Court has pronounced itself on the meaning and application of any provision in the Income Tax Act that its meaning and application cease to be debatable. It is then for Parliament, if it wishes, to amend the Act. The dearth of appeals from the lower courts to the Supreme Court of Canada has thus the rather regrettable consequence that no-one can ever be quite certain what the law really is where the final Court has not pronounced itself. In the interests of the nation as a whole it is therefore desirable that there be more appeals to the Supreme Court of Canada in order to clarify the meaning of a statute which affects almost everyone in the nation. This, of course, presents no problem to the government, which has unlimited resources at its disposal, but there are relatively few taxpayers who can even contemplate the expense of an appeal to the Exchequer Court and thence to the Supreme Court. Can anything be done about this? We believe that there can be.

Before suggesting a possible solution to that problem, there is another aspect of the matter which bears consideration. On one occasion some years ago a tax appeal involving an important question of construction was decided by the Exchequer Court of Canada ad-

versely to the Crown. No appeal was entered from that decision and no amendment to the Act was asked for by the Crown, from which we think taxpayers were entitled to assume that the construction placed on the enactment by the Court was accepted by the Crown. Taxpayers certainly acted on that assumption for a great many years, with the perhaps unenthusiastic acquiescence of the Department, but a little more than a year ago the Tax Department reversed its attitude and forced the question once more before the Courts - and on this occasion it succeeded in the Income Tax Appeal Board. The situation then was that there were conflicting judgments on the meaning of an important provision in the Income Tax Act. One can think of no situation more demanding an adjudication by the highest Court to put the matter beyond the peradventure of a doubt. Should that adjudication be adverse to the Crown, well Parliament has not in the past shown itself reluctant to meet the Crown's wishes — but of course in that event the Crown would be obliged to ask for an amendment antagonistic to taxpayers, and that might lead to debate in the House of Commons. In the case we mentioned the Crown followed another course. Ignoring the Exchequer Court of Canada and the Supreme Court of Canada, it went direct to Parliament, and appeared there in the benignant role

of one seeking to relieve taxpayers of a burden created by a decision of the Income Tax Appeal Board. The fact that the amendment would leave taxpayers in a far more disadvantageous position than before the Income Tax Appeal Board judgment, and, as we think, will have unfortunate long-run consequences, was overlooked in the pervasive atmosphere of benignancy which prevailed. And of course there was no debate whatever on the amendment.

What can be done to encourage more appeals to the Supreme Court of Canada on tax questions of general importance?

Where the Exchequer Court decides an appeal in the taxpayer's favour, on a question of general importance, the Crown, which represents all the people, should, we suggest, undertake in the public interest to bear all the costs of appeal to the Supreme Court of Canada, whether in result its appeal fails or succeeds in the Supreme Court. Such, we understand, is the willing practice of the Crown in the United Kingdom on tax appeals to the House of Lords which are of general importance. There, moreover, the Court of Appeal has power to impose such a condition as a prerequisite to the Crown's right of appeal. We could well do with something along the same line in this country.

CORRIGENDUM

The October issue of *The Canadian Chartered Accountant* contained an address entitled "La Banque d'Expansion Industrielle" which was attributed to Mr Lucien D. Viau, C.A. Mr. Viau, the honorary secretary-treasurer of the Quebec Institute, has asked us to inform our readers that the credit for the address should be given to Mr. Lucien Viau, L.S.C., Sous-Secretaire, La Banque d'Expansion Industrielle. Our error in confusing the two Messrs Viau is, of course, sincerely regretted.

The Audit of Management Methods and Systems

By E. D. MacPhee, M.A., B.Educ. (Edin.)

Director of School of Commerce,

University of British Columbia

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Why more accountants should prepare themselves to audit management procedures

NE of the evidences of continued ONE or the evidence profession health in the accounting profession is the debate that goes on whenever a few accountants are gathered together as to the proper scope of their duties and the professional limits to their responsibilities. This indicates their constant concern as to the goals, objectives and ethics of auditing; demonstrates that they are fully aware that the roles of the public auditor, the internal auditor and the accountant are being changed by urgings from without, as well as by conflicts from within the group, and gives assurance that as a profession they intend to examine both the internal and external stresses frankly and collectively.

Such contribution as I can hope to make will be by way of an analysis in the field of objectives, not in the area of techniques, plans, or methods. The pressures from inventors of mechanical aids to accounting; the transfer of the principles of statistical quality control from the field of product inspection to auditing procedures; the development of time-saving techniques in audits of receivables, payrolls; the elimination or modification of intermediate journals, all

these are matters of major importance to accountants and their clients. I have been greatly impressed and heartened as a businessman by both the vigour and the caution which have been directed to the examination of these developments and aids in the technical verification of records. But they are not the problems I want to talk about.

The Place of Auditing in Management

My purpose rather is to ask where this process of auditing fits into the overall structure of management, to try to develop certain principles which should guide those engaged in the practice, and to look at certain implications of these principles in the training of members of the accounting profession. These steps should enable us to find some points on which we can agree, others which we will continue to consider, and others which may be condemned as being simply provocative.

Let us turn first of all then to the question "Where does the process of auditing fit in the overall structure of management?" This is not an academic or theoretical question. It has been an-

swered in various ways by the accounting profession over the decades, and the conversation of auditors and accountants of various vintages of experience reflects the change. At one time the audit was regarded as an independent verification of assets and liabilities, reported through the Board of Directors to shareholders. Assets and liabilities all carried a dollar mark, and it was not in the field of the audit to investigate or report on any fact which could not have a dollar tag attached to it. hands the audit reported as well an examination of operating statements, with comparisons of present and previous years. Latterly trends in assets, liabilities, and expenditures have been increasingly the subject of reports to the Board of Directors, and even to the shareholders.

The terms I have used in this brief comment on trends bring out the essential and persistent characteristics of an audit as viewed by many auditors.

1. It is a process of communication. Legally and formally it is a communication to a particular group of people, viz. the shareholders of the company and to nobody else.

It is a communication of information which carries a dollar tag, and legally and formally need be nothing else.

Auditing for Communication

Let us look at these two ideas somewhat more critically, and ask first of all where the assumption that it is "a communication to existing shareholders" has led us. Of course, the audited statement and report goes to the Board of Directors, and if it has value and meaning to any group it has to them. But in these days of public companies it goes to many groups other than shareholders—to creditors, to investors and potential shareholders, to competitors, to employ-

ees. Because reports which are communicated from 13 to 18 months after the beginning of a financial period are of little value some machinery for interim communication had to be devised. Accounting offices were strengthened, internal auditing staffs were created, and the practice of formal financial reports being made directly by officers of the company to investors, on a quarterly or even monthly basis, came into existence.

All this is becoming standard practice in the U.S.A. and will come in the course of time in Canada and Britain.

The first point I would like to emphasize is that while in practice the existing shareholders may appoint the outside auditor, it is these other groups which have forced companies to publish dependable financial data for their uses and purposes. The growth of public investment in industry and the increasing importance of the large investment groups in the financing of our economy now mean that financial data are required and are being obtained and used by groups other than shareholders. It used to be possible for the president of a company to ignore the transactions in the shares of his company; he can no longer do so. It is no longer bad form for the chairman of a Board of Directors to be concerned about the distribution of company shares, or the price at which transfers are taking place. He must therefore take such steps as are necessary to ensure that what is communicated is authentic and accurate.

As a result, internal audit groups are developed, and interim reports issued which reduce, if they do not eliminate, the uncertainties which were previously resolved only with the appearance of the public auditor's statement.

Minimization of Public Auditor's Role

This important result which follows is that while the public audit must be continued in the interests of society, the role of the public auditor in the communication of dollar-tag facts has been minimized. His report is examined by the shareholder or investor, not as news but for confirmation of the accuracy of information already at hand. I suspect that one reason the public auditor finds it so difficult to raise his fees is to be found in this situation, and I suspect that as long as the public auditor looks on his job as one of providing confirmation this condition will persist.

It seems to me to be axiomatic that people will pay more for news than for confirmation of news, for reassurances that the financial facts they have accepted and on which they have based their investment practices are sound. If, of course, the public audit reveals malpractice on the part of management, or concealment of essential facts, then the auditors' report will cause a stir, and the auditor will be considered a public benefactor, but these cases are few.

From this argument I put forward, tentatively, the suggestion that the public auditor must add to his job if he is to meet the real needs of the investing public in this modern, corporate, investment-minded age. I will promise to make this suggestion more precise as we proceed.

Dollar Data not Enough

The second assumption made by some public auditors is that the information they communicate is adequate if they confine themselves to the dollar-tag data; they seem to assume that a report on these data, applied to completed and recorded transactions, synthesizes all the useful information about the company. There are two points here which need examination, which may be phrased as questions; viz.:

First: Do the dollar data, alone, for a year, portray the position of a company? Does a series of dollar data, for a num-

ber of years, give an adequate picture for the shareholder, the investor, the creditor?

Second: If not, what other data are essential?

I will try to state my opinion on these questions in a number of specific propositions:

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- 1. The increasing number of footnotes and interpretive comments now appearing shows that the public auditor feels the necessity for adding supplementary information, to conform with the spirit as well as the letter of the law. finds particularly that in consolidations, in matters of depreciation, and in descriptions of surplus accounts he must supplement the balance sheet facts by other descriptive data. The more complete the reports of the chairman, president, and general manager are, the fewer may be his additions, but I think I observe a trend to ensure that in one place or other the shareholder, the investor, and the creditor are told not only "what", but "why", and "when", and "how". These points necessarily lead one into data which to the reader do not have a clear-cut dollar tag, but they enable the shareholder, investor, or creditor to understand and to act more prudently in his forecast.
- 2. In the August 15, 1953, issue of *The Financial Post* there appears an analysis by Dun and Bradstreet of the causes of failure of 843 business houses in Canada during the year 1952. The figures are interesting: 205 manufacturers failed with liabilities of \$7,787,000, an average of \$38,000, and 73 wholesalers failed for an average of over \$30,000 each. It is not just the corner grocer or cleaner who goes broke.

But what struck me as most significant in the analysis were these figures:

5.2% failed because of neglect and poor health

2.1% failed because of fire, burglary, strike, and other disaster

1.5% only failed because of fraud by the principals

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90.1% failed because of lack of managerial experience and incompetence.

Auditing Managerial Competence

To state it otherwise, 90% of failures with liabilities totalling \$20 million did so because they lacked managerial experience, but only 1.5% because of fraud. The work of public auditors would expose the 1.5% group. Who is to make it his job to help train the 90% who fail because they are incompetent or insufficiently trained? We have had a long period (almost a decade) of a very low failure rate; a return to the 20's would quadruple the rate. Do accountants feel that they must leave this field to the banker, to the management consultant, to a friend? If so, why?

It is my proposal that as the years go by the accountancy profession should add to its present responsibilities in the detection of fraud and neglect, and should become involved in the audit of management methods and systems. This is the constructive role for the public auditor of the future. years have passed, the legitimate demands of shareholders and investors for financial information are being met by the financial administration of companies themselves. The fact that such a large percentage of the C.I.C.A.'s membership is now engaged in financial administration in industry is a further guarantee to the investor that good accounting practices are being followed, and honest reports issued. The urgency of the need for their services in the direction of certification is decreasing. On the other hand, there is increasing need for help in management problems, in some of which chartered accountants are fully

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qualified to help. If they are to be fully useful in some other fields, however, their training program will have to be modified.

Let me try to make this proposal more precise by referring to my personal experience.

What the Auditor Can and Should Do

I have been audited by firms both great and small, by men of wisdom and experience and by others who had neither. The best of them, however, were being paid as auditors and I have no right to expect them to act as anything more.

What more could that be? Naturally I consulted with them, along with investment bankers, on any refinancing proposals, but their role was largely the preparation of the financial and historical data specified by the bankers. I consulted them annually, and generally took their advice on questions of income taxes. But you will note that these refer only to occasional matters, very import-

ant and significant, but still infrequent.

The things on which I wanted guidance were matters which came up frequently in management methods and systems. In the Board we would have to decide on a policy, say, with regard to authorization of purchases beyond a certain amount in dollars or extending beyond a certain period of time. What do other people like ourselves do? What do prudent businessmen find wise in this market at this time? These are questions a good Board member asks. Then, having decided and announced the policy, the question arises — what is the cheapest effective procedure to check compliance with, and adherence to, the policy by the purchasing or stores department? Again, one could, and one does, develop a procedure eventually but it would be a real help to the manager if he could get counsel and guidance on these points from a professional man.

The Auditor and Administrative Control

Take any other of the basic problems of administrative control. Let me list a few, and as I do so, please think whether you could be helpful and useful to your clients in answering some of the problems posed.

- (a) Budgeting capital expenditure in the light of the stage reached by our business, the market potentials, the economic outlook, other current operating requirements, and so on.
- (b) Setting up wage compensation plans, based on sound job classifications, establishing the administrative machinery to handle these plans, and providing the machinery which would show up improper conditions or undesirable trends.
- (c) Establishing standard costs, devising cost records and control devices, and tieing these in with product costing, with cost controls and with other financial records.

Up to this stage you are probably thinking that you are on familiar ground, but how many of you are consulted by your clients with a view to constructive help? The facts that other consultants are engaged by so many small firms, and that so many large firms develop their own specialized staffs in these areas of management make this question a pertinent one.

- (d) Let us move a bit further away from financial problems. Every senior executive is concerned, and often critically, with his organization. He asks himself over and over whether he has the most effective definition of department responsibilities; the best grouping of departments under a vice-president; where other firms place credit control or advertising; what steps other presidents are taking in long-range planning of executive personnel. Can you advise? Can you point out weaknesses in his own planning? Can you suggest criteria by which he should measure the efficiency or inefficiency of any one department manager, other than profits? Do you? Should you? Or should this be left to another outside consultant?
- (e) The major day-by-day-worry of a president is whether his product-range is competitive in quality and price, whether it is over-expended, whether he is carrying too many relatively unprofitable lines, how he can turn unprofitable lines into profitable lines by new machinery, or layout, or staff. This is, of course, the field of production know-how and presumably the manager has the knowledge himself of how to approach this problem, or has someone on his staff who does know how to investigate this question. I have been greatly helped at times by suggestions, not of specific solutions but of methods of studying the problem. Is this field entirely remote from the duty of a public accountant - or is it all the field of the specialist?

(f) One of the major headaches of all management today is the rising cost of distribution, and most senior executives are concerned to devise some form of control in this field. The purposes of control, as we use the term, are, first of all, to inform executives of what is going on, but this is only a part of it. Certain sales policies have been defined; are they being adhered to? Certain volumes of sales, margins, and expense ratios have been pre-determined; are they being achieved? Management must decide if the volumes, margins, and expense ratios are not being maintained whether the fault lies in the standards set, the plans made, or in the carrying out of the plans by the sales manager and his staff. Various devices are used to inform the executive of what is happening and where and when it is happening. Some of these records arise directly from the accounts, others from the sales force. Good sales management makes use of budgeted costs and estimated selling prices. The sales manager is usually the person who decides on selling prices for various volumes, areas, and so on. The comptroller is usually responsible for analysis and comparisons of actual versus standard margins. The financial administration is responsible for establishing and operating the numerous budgets necessary to give expense control, and for distribution cost accounting. At many points the problems of the senior executive are these - how many of these control records can I obtain as by-products of my general accounting system if I go about it in the right way? Who knows of a system of distribution cost accounting which could be adapted to my size and type of business? If on the surface it appears that an account buying less than say \$100 per year is unprofitable to sell, from the standpoint of the sales manager, what would be the effect on manufacturing costs of dropping

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those accounts? Are my accounts set up to give me this type of information, or could they be?

Management Recognizes Need for Help

These six points will illustrate, I hope, my thesis that management today in every phase of its operations is recognizing the need for advice, demonstration, suggestions, on how to do a better planning, organization, and control job. They may not say so in these words, but there is ample evidence otherwise. The rapid growth in the number of management consultants; the rapid and persistent increase in attendance at evening classes in business administration in every university and college city in Canada, U.S.A. and the U.K. - all these evidence the search going on for improved methods, procedures, and systems. Management is ready to pay for this service.

My question is whether the public auditor should, in the future, plan to accept responsibilities in these directions, with the inference that he should, or whether it conflicts with his professional code, with the inference that it does not.

Future of the Accountant

I have ventured to urge that an increasing number of accountants should, as the years go by, prepare themselves to audit management methods and systems. I am not suggesting that they manage the industry but that they communicate to management their findings on control agencies in operation, better types of organization and control in production, sales, wage compensation plans, and so on. I do so because in many small and medium-sized firms the introduction of these systems and procedures are set up independently of financial records when they could derive from them; many are departmentalized when they could be coordinated. I do so because the public auditor has an opportunity to raise the general standard of practice in management procedures more readily, and on the whole more effectively than any one group I know.

Please note that I have said that "an increasing number" should "prepare themselves to audit management procedures". These terms are used advisedly. Some chartered accountants are doing this work now. Some will refuse to have anything to do with this proposal. Others will attempt to do it without adequate preparation. It is not a field for the new C.A. without professional experience. It is not a field for the man who temperamentally is unwilling to see his suggestions discarded or modified out of recognition, for that too will happen. It is not a field for a man who has a pet system to sell; he will soon lose his professional standard if he does.

It is a very satisfying experience for one who is prepared to study each new job thoroughly, carefully, and without prejudice as you now do in your present field, and one who will then in the light of his experience, and his analysis, devise a system which that management needs and that management can use. A management audit starts, as does a financial audit, with a detailed investigation; it leads similarly to a communication to management of procedures and systems which will give it better control of its business.

Four Premises

I have tried to develop in this address four premises:

- (1) The role of the public auditor historically has been that of communication of dollar-tag information to the shareholders. This vital job must be continued.
- (2) The demands of investors are forcing companies to create accounting and auditing practices within their own

organizations which enable them to disclose, in interim reports to the public, the types of financial data previously disclosed only in audited statements; as a result the role of the auditor in communication is being minimized.

(3) Dollar-tag information should not be regarded as an adequate communication to shareholders by the auditor.

(4) Business management and society in general is the loser from a narrow definition of the responsibilities, duties, and privileges of the auditor. There are many fields in which the auditor is qualified to become the consultant and adviser of management but where tradition prevents his operating in that manner. This tradition should be carefully examined and over the years the historic definition of the type and direction of the communication should be altered in the interests of shareholders, management, and society as a whole.

Three Conclusions

On the basis of this argument I wish to offer the following propositions:

(1) It is in the interests of shareholders and potential investors that public auditors should 'regard the audit as a communication of such financial and non-financial data with regard to a company as will enable them to act prudently in participating in that industry.

(2) It is in the interests of shareholders that communication to management of improved management practices and procedures be the privilege and responsibility of the public auditor. This function is not in conflict in any realistic way with the discharge of responsibilities to shareholders, but is a condition of adequate discharge of these duties.

(3) It is in the interests of the profession and of society that an increasing number of public auditors prepare themselves to participate in the audit of management systems and methods.

Canada as a Challenge To the Accounting Profession

By Walter J. Macdonald, M.C., F.C.A.

President,
The Canadian Institute of Chartered Accountants

A few vital facts concerning the "unknown country"

MY prime responsibility today is to bring to you the greetings of the 5,400 members of the Canadian Institute of Chartered Accountants, and their good wishes for the success of your 66th annual convention.

On our side, we feel that no annual convention would be complete if we did not have among our guests a representation from your body. Your presidents have done much over the years to foster the friendly relations between the two Institutes. Your John Carey and your Carman Blough are familiar figures to us, welcomed as friends of our executive and more or less intimately linked with us and with our thinking.

We regard your Institute in the light of a big brother. We are impressed with your research into accounting principles. Your bulletins have aided our own research, and, within our limited budget, we are following your example in similar publications, and with no great divergence from the positions which you have adopted in yours.

That mutuality of interest and of thought between the two Institutes is a lively and a continuing source of satisfaction to all of us in Canada. We feel that we are marching together with you and are thereby strengthened in the tasks which face us and which face you also.

Turning to the subject which I have chosen, "Canada as a Challenge to the Profession", I could have discussed with you the work which our Institute is doing in recruitment and training of personnel; in research into the professional subjects; in education (and we pride ourselves that our uniform examinations are accepted by our constituent Institutes in all of the ten Provinces); about our work in conjunction with the Canadian Bar Association on taxation; or about co-operation with other accounting bodies. Any one of these subjects would have been interesting and informative.

I have chosen, rather, to discuss with you some broader aspects of Canada in relation to our profession. If I have transgressed my terms of reference in so doing, I am sure that — with your customary courtesy to Canadians — you will forgive me.

In this talk I have sought to view Canada through the spectacles of an av-

erage member of your great Institute. I should say also at the outset that I come from Winnipeg which, from its geographical position, corresponds in your country to Chicago. There is a further point of similarity in that much of the grain trade in both countries is directed from these two cities, and that both are focal points in the railway systems of the continent. (Curiously, the geographical centre of the North American continent is located, not as one might think, south of the 49th parallel but actually close to where I live some 60 miles north of that boundary in Manitoba).

Looking at Canada from that viewpoint, what I have to say might be biased in terms of the "wide-open spaces". Your objective thinking will counteract that.

What is Canada?

From our side of the line we know something of the United States. We read your periodicals. We listen to your radio. We see your movies. We see your television. We know you fairly well. But the reverse is not the case. To many of you, Canada is a relatively "unknown country". Our Canadian periodicals do not have a large United States circulation; your periodicals do give us coverage but usually on the more sensational aspects of our national life. Our radio, operating on a limited budget, does not command an American audience. We have no native movie industry of any magnitude; your movies of Canadian life, interesting as they are, must be framed largely with an eye to box office appeal south of the line. Our television is yet in its infancy (although we did bring the Coronation to you ahead of your own services).

Thus, I do not feel presumptuous in trying to lay before you a few vital facts about my country, some of which at least will be new to you.

Canada's Six Areas

Looking at Canada's surface, there are six distinct areas, the greatest of which is that covered by the Precambrian or Canadian Shield, the oldest rocks on this planet. The Precambrian is, from the air, half water and half land. The land is, of course, clothed with an overburden which produces timber of the pulpwood variety. The Shield starts from the east bank of the Mackenzie River basin to wind up covering the whole of Quebec and the coast of Labrador.

Quebec is bigger than Texas, in fact, twice as big!

That is the main geological feature of Canada. It covers one half of the land.

The second feature is the Rocky Mountain area which, compared with the Precambrian, is a very young rock formation. British Columbia and our Yukon territory are entirely in the Rockies and the terrain is similar to your Rocky Mountain States south of the border.

The watershed of the interior plains is just north of Edmonton. Thus a third area is the Mackenzie River basin. This river flows from just north of Edmonton to the Arctic—some 1,100 air miles.

South of the Mackenzie basin and spreading from the foothills of the Rockies in Alberta some 800 air miles to the Manitoba-Ontario boundary due north of Minneapolis, we have the prairie plains. Their counterpart is in your States of Montana, the Dakotas, and Minnesota. This area is a prime source of our agricultural production as it is a main source of yours.

The Maritime Provinces, and Newfoundland, are in the Appalachian region corresponding geologically to your Appalachians.

You will observe that in these five areas we have encompassed a very large part of Canada. What remains is largely a peninsula (including Niagara) centred on Toronto, and the relatively narrow cultivated region south of the Precambrian bordering on Ottawa, Montreal, and Quebec. Before leaving this surface picture of Canada with you, may I point out that many of you know Quebec City, Montreal, Ottawa, Toronto, Hamilton, and Windsor because of the strategic positions they occupy in our financial and production economy (manufacturing produces 30% of our national income). But I do wish to leave the thought with you, without deprecating the position which these Eastern areas hold in your thinking and in ours, that they occupy a very small part of Canada's land surface.

And of course we must recognize the Great Lakes and the St. Lawrence which are the common heritage of our two countries and a common gateway to the Atlantic through Canada.

Turning to the production of these different regions we see that the Shield is the prime source of our base metals — copper, lead, zinc, and nickel — of our precious metals as well, and now of uranium for atomic power. And Mother Nature has clothed the Precambrian with the trees which we use for paper.

Of recent years we have developed and are continuing to develop our iron mines in the Steep Rock area just north of your Mesabi Range, in the Michipicoten area north of the Sault, in Newfoundland and now on the Quebec-Labrador boundary (Knob Lake).

From the western slopes of our Rockies we, like you, draw our timber. The counterparts of our British Columbia forests are in Washington and Oregon.

Centred at Trail in British Columbia near your border and at Brittania on the Coast, we are producing lead, zinc, and copper in quantity, also silver and gold, and we are discovering and developing new sources of lead and zinc, copper and nickel across the whole area of the Rockies. Here again we follow your pattern. Your non-ferrous mines are principally in the Rockies, from Montana and Washington to Arizona.

On the eastern slopes of the Rockies we find bituminous coal and oil, and reaching far down into the prairie areas we are now finding oil, as you do in Oklahoma and Texas.

From the prairies we produce, as you do in your Prairie States, grain, cattle, and agricultural products of every kind, and lignite coal.

And in our Atlantic Provinces we are finding new sources of base metals and have always found coal, iron, and timber, much as you do in your Appalachian area south of the border.

You are conversant with our rapidlygrowing manufacturing industries, and our industrial production received a great impetus from the "know-how" developed in production for World War II.

Canada Grows Northward

In the United States in the days of the covered wagon you pushed back the wilderness until you met the settlers who had come by other routes to the Pacific Coast. Correspondingly, we in Canada have pushed west with the Canadian Pacific main line as the backbone of that movement, until we met the colonists who had voyaged around Cape Horn to settle in British Columbia. In the old days in both countries the slogan was "Go west, young man, and grow with the country". The west has grown and I think it is proper to say that in both countries the westward growth is approaching the saturation point.

In Canada we are now looking north and we are pushing our transportation facilities always northward. On both coasts we have northward access by sea. In the far west we have two railroads running north: one from Vancouver to Prince George, the other from Edmonton into the Peace River country. It is inevitable that these two railways will be joined up and that the next step will be a railroad pushing still northward and paralleling the Alaska Highway. That highway, built by you, is a source of pride to us, if only as a symbol of national co-operation, and it is opening up entirely new areas to civilization and to development. The Mackenzie River gives another outlet to the Arctic.

In Manitoba, (1,000 air miles north and west of Chicago) we have recently built 150 miles of rail north of the previous end of steel at Sherridon, to reach the new nickel mine at Lynn Lake. Lynn Lake and Churchill on the Hudson Bay Railway are the northernmost points of railway penetration on this continent. Lake Winnipeg gives 300 miles of navigation northward to Norway House. East of there we have the Northern Ontario Railway running up into James Bay, an offshoot of Hudson Bay.

And now we have the 360-mile line to the new iron fields in Labrador which will soon be sending ore to a St. Lawrence port (Sept Isles) for shipment to your mills at seaboard or in the Cleveland-Ashtabula-Pittsburgh area.

It is thus in the north that much of our future growth must come. The Shield holds much promise. Presently operating mines are nearly all on its southern fringe, accessible to the prospector and near to railway lines, but air travel and new methods of prospecting are constantly exploring the hinterland and probing farther into its secrets. The Precambrian provides natural storage basins for river power generation. On its western and southern borders we are finding abundant signs of uranium.

The other northern areas are equally promising. The oil at Fort Norman, the untouched tar sands of Athabasca, the asbestos deposits of the northwest, and the new base metal finds in the Yukon prove this. And the latest development to produce aluminum ingots at Kitimat in northern British Columbia, with its potential two million horse-power of electric energy, cannot be lightly passed over.

This picture of Canada productionwise is, of course, drawn with a very broad brush. Of necessity it is incomplete. To restore perspective may I repeat that the geographical centre of this North American continent on which our two nations live and move is near the capital of Manitoba (Winnipeg) some 60 miles north of the 49th parallel.

Our Integrated Economies

Apart from these geological similarities, there is a substantial interrelationship between your economy and ours.

Our export grain and yours, particularly the hard wheat of our prairie areas, is deliverable on world markets at prices established in Winnipeg and Chicago — and now once again, after 14 years, quoted on the (Liverpool and Baltic) Exchanges of the United Kingdom.

Our copper and zinc and lead, like yours, is sold "basis delivery at your eastern seaboard", at prices determined by the metal exchanges of New York and London.

Your manufactures in many fields have their counterparts in our country, many of them subsidiaries of United States corporations; correspondingly, some of our major industrial companies have counterparts in the United States.

We import your citrus fruits and your early vegetables, your textiles and heavy durables, in very substantial

volume.

Our lumber moves, inter alia, to your markets.

Your newspapers in large degree are printed on paper that stemmed from Canadian forests.

Our gold goes into your vaults (or has done so until recently).

Substantially all of your nickel comes from Canada.

Our uranium goes into your atomic bombs.

Here again I have used broad examples to show the integration of our two economies. You will fill in many gaps in what I have said.

Other Comparisons

The motto over our House of Commons doorway reads:

"The wholesome sea is at her gates, Her gates both East and West".

Our Atlantic seaboard is some 3,000 miles from our Pacific shores, and our Northern boundaries in the Arctic some 2,400 miles from our Lake Erie shore. These measurements compare roughly with those of your country. In terms of square miles it is conceded that we are bigger than you are. In population you outnumber us more than 10 to 1, but our population is growing more rapidly than yours. From 1946-1952 Canada grew 17.4%, United States 11%, and our gross national product is now four times what it was in 1939. We are a young country but growing faster than your more mature economy.

Like you, we are a hard-currency country. In national income per capita the average American earns nearly \$3 for every \$2 that a Canadian earns.

In addition to being a close neighbour, we are your biggest customer. Britain and Argentina run second to us on your customer list (we buy \$4 from you for every \$1 that they buy). But we buy more from you than we sell to you: for every \$3 of Canadian products which enter your markets, \$4 of U.S. pro-

duced goods move into Canada. That pattern has persisted so long as to have become almost traditional. Naturally it creates an imbalance which we have to rectify by selling more of our product to other countries than we buy of their products from them.

We are presently plowing back 23% of our national income into capital goods. Our annual savings are sufficient to pay for all of our capital development. The investment dollars, which are coming into Canada freely from countries like your own, are offset by Canadian dollars flowing into investments abroad. We are standing even with the world, and we seek no favours from any one.

Add to all that I have outlined the fact that incontestably our two nations are bulwarks of free democracy, free enterprise and free people in a sea of international turmoil, and that in defence against potential invasion we are willy-nilly in the same boat, and I think you will agree that we must each understand the other to the greatest possible degree.

In these modern days, civic, state, national and international decisions reach down into the affairs of even the smallest business that we public accountants may serve. And that is where I see the challenge to our profession in both countries.

A Challenge to the Profession

We accountants are fundamentally fact-finders, not case-makers. We cannot state the assets without the compensating liabilities; we cannot state the income without showing all of the concomitant expenditures. In our training we develop a faculty for analysis, and a keen sense of relative values; we have some capacity for objective thinking and logic in presentation of the facts we find; we pride ourselves on the independence of the opinions which we express — and above all we aspire to be intellectually

honest and to show integrity of character in our business dealings.

Is there not a challenge to bring these attributes to bear on our public policy and our joint position in the international and national fields, at all levels of public thinking? To our profession in Canada I see the challenge to enter more fully than in the past into consultation with our policy-makers so that their decisions may be founded on fact. And thus that Canada may stand right with the world and four-square with your great country, in the path of progress where we have so many common interests.

To you as fact-finders for your country I suggest that you study us, our economy, our politics, and our social characteristics, on the basis that our destiny is closely integrated with yours.

If we chartered accountants serving the public on our side, and you certified public accountants on your side, each have a full understanding of the facts pro and con, and are listened to on both sides of the border, there should be much less difficulty in arriving at decisions which concern our two nations.

I have spoken of the path of progress which we both seek to travel. We are free, democratic nations, each standing on a foundation of rugged independence and, undoubtedly, under our democratic system there will be stones discovered on that path. Some little stones can be rolled away easily by one party or the other; some are bigger ones which will require leverage from us both.

Among the little stones which have fallen on the path I could mention the fact that you have a duty on nickel coming into the United States whereas, so far as I can find out, not one pound of nickel is produced in your country. Another difficulty lies with some of your labour leaders who come to Canada to recommend parity of our wage rates with

yours, but fail to recognize that our income per capita is not on parity with yours. I have already mentioned the 3:2 ratio in that connection. On the Canadian side I have not yet found a valid reason for the much higher prices we pay for household goods.

Among the bigger stones, we have to recognize the fact that, while our frontiers are undefended on either side (Rush Bagot Treaty), both of our governments have erected tariff walls, each against the other. On our side of the line the claim is made that our country is flooded with your nylons and other textiles, while on your side of the line heavy pressure is being brought to bear to prevent our coarse grains coming into your country. Recognizing that tariff barriers cannot be rapidly eliminated without dislocation of industry, I submit that in light of our integrated economies and our mutual position in defence, this is no time to build these walls higher. The joint need should be supplied from the most economical source. Sound cost accounting should have a bearing.

The deliberations of the international body which is reviewing the general agreement on trade and tariffs (expiring in 1953) are a matter of vital importance to both our economies and deserve the closest consideration.

In another area, there was no trouble in arranging that your wartime traffic should cross Canadian territory and that the Alaska Highway should be built. Correspondingly, we are happy about the radar screen in our north country and, of course, our joint participation in N.A.T.O. We on our side of the line and, I am sure, you on your side cannot see any over-riding reason against the St. Lawrence Seaway. Undoubtedly there are opponents on both sides. Our inland shippers are concerned about foreign competition; your railways are concerned about the diversion of traffic

from their lines, but again I submit that when the debits and credits are added up, our joint national good can best be served by low cost access to the markets in which we sell and from which in consequence we must buy.

From my observations, we in Canada are ready to cut sod on the Seaway. Our plans are complete. Make no mistake about Canada's position on that question. We are going ahead.

It is to matters such as these that I suggest we apply our analytical faculty, our sense of relative values and the other capacities which we pride ourselves on having developed, in particular the capacity to form an independent opinion. In result, the area of controversy in many of these issues can be eliminated, or at least considerably narrowed down, when all of the facts, financial and economic, are put on the record, the consolidated surplus or deficit is clearly shown and, more importantly, made known to the public.

You will agree with me that the very best financial statement or factual analysis is useless if it is not transmitted to those whom it may affect, and in that field of publicity our friendship with the press should be cultivated. Among my own most valued friendships are those I enjoy with the gentlemen of that fraternity; friendships made stronger in that they were often forged and proven in the heat of controversy.

In conclusion I am suggesting to you that in these days we accountants cannot allow our view to be circumscribed by the narrow confines of the balance sheet. We must lift our sights. It is true that we now accept many responsibilities beyond pure audit. Management seeks our advice on tax, on methods, on problems of delegation and the like. But that is all strictly dollar-fee business. Properly to fulfil our function to the public (using that word in its broadest sense)

should we not also think of the service we can perform with or without fee in audit of the facts on which our national decisions are based? And should we not see to it that, with *all* of the debits and credits brought to account, independent opinions are formed and expressed?

Our two Institutes, yours in all the strength of maturity, ours smaller but like our country rapidly coming into adult manhood, through their members, have contact with a fine cross-section of thinking men in both countries. We seek to set forth the truth in our reports to them on their own affairs. Should we not, if only in the interests of our own security, see that they are properly and fully informed on public issues? And certainly in that field the issues with Canada are very close to home.

We in the United States and Canada have not yet seen our cities flattened like Berlin and Hamburg or Birmingham and Coventry (1,200 men, women and children were destroyed in that small town in one night). We face that threat now. In my view our freedom and our lives are at stake. Can we stand inarticulate and see tariff doors hysterically opened and closed, on either side of the border, against production which must be stable if our integrated economy is to stand up in the defence of our common territory against a totalitarian state? And aside from tariffs there are other issues of like magnitude where we must stand integrated. Our common good must be considered. These things should not be settled by political pressure from small but vocal minorities.

I have spoken of your country and my own — and of these two alone. The hopeful eyes of every civilized country are centred on us — not so much for dollar aid but for moral support from the example of a common front. I leave that thought with you.

Bruce Hutchinson in his book on Can-

ada, "The Unknown Country", says:-

No one knows my country, neither the stranger nor its own sons. My country is hidden in the dark and teeming brain of youth upon the eve of its manhood. My country has not found itself nor felt its power nor learned its true place. It is all visions and doubts and hopes and dreams. It is strength and weakness, despair and joy, and the wild confusions and restless strivings of a boy who is past his boyhood but is not yet a man . . . But no people of our numbers has ever occupied such a place before in the floodtide of history, for we are of two worlds, the old and the new, one foot in each, knowing England, knowing America, joined to each by blood and battle, speech and song. We alone are the hinge between them, and upon us hangs more than we know.

That last sentence throws a heavy responsibility on Canadians. A challenge

which no thinking Canadian can ignore.

The same author describes Canada in these words:—

Wondrous and very sweet is our name Canada!

Can we not hear it in the rustle of yellow poplar leaves in October, and in the sudden trout-splash of a silent lake, the whisper of saws in the deep woods, the church bells along the river, the whistle of trains in the narrow passes of the mountains, the gurgle of irrigation ditches in the hot nights, the rustle of ripe grain under the wind, and the bite of steel runners in the snow.

That is the Canada which lies at the back of what I have said. Your experience will develop your counterpart picture of your own country, from Alaska to Florida, from California to Cape Cod.

I leave these two pictures with you.

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OPPORTUNITIES OF THE "FIGURE MAN"

If I were put in a corner and had to specify what I thought was potentially the most profitable profession (in the strictly money sense, of course) for a young man to enter I would say — accountancy.

True, the financial rewards in the early years are small. But the opportunities are great. For accountants today are more and more the rulers of British industry. In an age when business becomes increasingly complex the services of the specially brilliant "figure man" become more and more important.

Probably in no other profession is it easier for the outstanding man to combine earnings from professional practice with income from actual direction of commercial enterprises.

And with his training and specialized knowledge the accountant is better able than most to distinguish the good investment from the nor-so-good.

The satisfaction of being a "professional man" — plus the advantages of being in on the inside of business — does any career offer better chances?

Bernard Harris in The Sunday Express, London, August 16, 1953

Some Notes on Witnessing Pay-Offs

By George C. Watt, C.P.A.

A case study of the audit procedures involved in witnessing a pay-off

TITNESSING pay-offs is often referred to as one audit procedure and seldom does accounting literature spell out the many detailed steps. Several years ago, a client asked that on a date of our choice we simultaneously witness the pay-offs at his divisions and subsidiary companies located in the East. Accordingly one audit program was created to guide many assistants, who were able to adapt the steps to local conditions without extensive rewording. Varying the emphasis in auditing procedures on annual engagements is a well-recognized prerogative. Witnessing pay-offs does not add appreciable time to normal engagements as there are compensating savings, such as a reduction in the extent of (1) cross-checking payroll information with personnel data, (2) tracing payroll information to time cards, and (3) examining endorsements on payroll checks or receipts for cash.

From the public accountant's point of view, witnessing pay-offs offers the benefit of getting the auditor in contact with operations and, like the observation of physical inventories, provides an opportunity to relate book entries with physical existence. It also has a good psychological effect for the auditor to contact the paymaster, superintendents, foremen, and workmen in the course of witnessing a pay-off.

The original program (shown on the following pages) allowed for a variety of local situations, but no single location involved more than 400 employees.

Mr. George C. Watt, C.P.A., has been a member of the New York Society of C.P.A.'s since 1948, and is also a certified public accountant of Pennsylvania, Indiana, and Kentucky. He is a member of the National Association of Cost Accountants and the American Institute of Accountants. From 1942 to 1946, he served in the Navy Cost Inspection Service where he held the rank of Lieutenant Commander. He is a manager with Price Waterhouse & Co.

280

Observation of Payroll Pay-off WORK PROGRAM

Location: Payroll	period ending:		******	Wor done by
Name of payroll:				-,
Key to Client's Pay-off Procedures at Location to be Tested:				
 Bulk cash is received via armed guard s bank. Envelopes are filled by clerks at the 				
Cash-filled envelopes are either received v obtained at the bank by an employee of th				
3. Payroll cheques are prepared at the plant.				
Note — X = Step not applicable to particul steps below under appropriate procedure num			Pay-o ocedu 2	
General:				
The purpose of this program is to ascertain that or month as recorded in the general ledger and to bona fide employees. The use of the term that the assistant arranges for the client's employe in such a way that the assistant may observe times. It does not imply that the assistant shoul	cash records is distributed "control" hereafter means tes to go about their duties he cash or cheques at all			
Work Program:				
 Familiarize yourself with the client's pay-of permanent file, last year's working papers, tention of witnessing current pay-off at the tainly after the payroll (register) sheets are 	etc. Announce your in- latest possible time, cer-			
2. Upon arriving to witness pay-off, assume payroll sheets; foot the net pay column. The bursement from the regular bank account to and trace to the entries in the cash account tinue to control payroll sheets until the community. a. If cash-filled envelopes are received.	Trace this total to the dis- the payroll bank account, is in the cashbooks. Con- apletion of the last step.			
next with step 5. b. If pay by cheques (procedure 3), trace and proceed next with step 6 while the		X		X
your control.		X	X	
 (Procedure 1 only) Record the total amount shown on the recemployee when bulk cash is received from or from the bank and agree this figure to sheets. (Where cash is to be obtained accompany client's employee to the bank.) 	the armed guard service the total per the payroll		x	x
			Λ	A

4. (Procedure 1 only)

Check empty envelopes to the payroll before the receipt of bulk cash. Control empty envelopes. Observe the insertion of cash in the envelopes, maintaining control of total cash only. (It is not necessary to determine that each individual envelope was accurately filled; simply determine that all cash received went into envelopes which you control.)

5. (Procedure 2 only)

Assume control of the filled pay envelopes when received from the armed guard service or bank. Trace the envelopes to the payroll sheets (name and amount) or, at the conclusion of the pay-off, trace to the payroll sheets the individual signed receipts which employees exchanged for cash envelopes.

Note—In maintaining control of the payroll envelopes, be certain that at all times a representative of the client is maintaining control with you.

- 6. When the distribution of the envelopes (cheques) is to be made, request the paymaster to distribute the envelopes (cheques) in such a manner that you are at all times in complete control of all envelopes (cheques) to be distributed to bona fide employees. Accompany the paymaster as he distributes each envelope (cheque), receiving the employee's signed receipt (if any) on cash pay-offs directly after signature. Where employees are not at their regular department, ask them for identification. If the payroll is normally distributed by more than one employee, arrange to do one of the following:
 - Obtain the number of assistants required to match the number of employees who distribute envelopes (cheques).
 - b. Arrange with client that for this one pay-off he stagger the pay-off throughout the day to permit you to accompany one at a time each of his clerks who normally pay off. Seal the inactive envelopes (cheques) behind you at each trip from the central location.
 - c. (Least desirable) As in "a" above, but obtain the help you require by using client's employees who have no relation to payroll, tabulating, timekeeping, personnel, or cash work.
- 7. List all unclaimed envelopes (cheques) and ascertain, by conversation with co-workers of the absent employees (other than foremen, time-keepers, or tabulating department operators), that the absent employees are actually employed by the client. The existence of night watchmen, truck drivers, travelling salesmen, etc., may also be established in this manner. (If possible, perform this step when accompanying the paymaster making the distribution. The paymaster may retain the unclaimed envelopes, but if the paymaster is an employee who has many other duties, it is customary for him to turn unclaimed wages over to the personnel department.)

Pay-off procedures 1 2 3

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- 8. Trace the employees per the payroll sheets supporting this pay-off to the employees per the payroll sheets of a payroll paid, say, three weeks prior and thereby:
 - a. Account for all employees on the payroll sheets of that prior payroll who are not on the payroll sheets of the payroll under observation by tracing to proper authorizations to remove employees from the payroll, taking care to note termination date per personnel department records compared with payroll records. Also verify the existence of these terminated employees by conversation with co-workers (as in 7 above). It is also desirable to account for employees on the payroll sheets of the witnessed payroll who were not on the payroll sheets of the prior payroll. If this involves much time, however, rest a few cases only to personnel department information.

General — It is difficult to witness a pay-off with certainty that it was done as a complete surprise. Therefore, the above step 8a is of extreme importance for it may locate fictitious names on those prior payroll sheets (which were certainly prepared without prior knowledge of a payroll audit). Such prior payroll should be the one used in the regular cash payroll work program, if possible. An illustration of payrolls selected follows:

Date of payroll tested under payroll cash work program. Week ended — Sunday 19/10

Surprise interim work started by arrival at plant — Thursday 30/10

Witnessed pay-off of week ended — Sunday 2/11 (payday) Friday 7/11

(Account for all names on 19/10 payroll not reappearing on 2/11 payroll.)

Having reviewed the client's procedure (step 1) and observed the pay-off, offer suggestions for strengthening internal accounting control.

This program represents a general check list. The assistant in charge is responsible for revisions necessary for its application to the specific location. (To be initialled by assistant in charge.)

General Notes:

- Where the client has a paymaster (or an employee who assumes duties
 of a paymaster), it is preferable to observe his procedures and later
 write a memorandum containing suggestions for improving his procedures. In such cases, use this work program as a check list.
- Where the payroll contains more than say 400 names, the above program may be used as a guide, but many steps will require limitation.
- 3. It is not contemplated that the program be carried out every year at every plant. In years when it is applied, a corresponding reduction in time spent in reviewing endorsements and cross-checking to personnel department information is permissible.

Notes on the Development Of the Accountancy Profession (Part II)

By J. E. Smyth, C.A. Associate Professor, Queen's University

A discussion of the forces and factors underlying the growth of accounting and the accounting profession

THE DEVELOPMENT OF THE PROFESSION IN BRITAIN

THE profession in Britain first developed around bankruptcy proceedings but it was the growing importance of the joint stock company towards the end of the nineteenth century that really put the profession on its feet. The Society of Accountants in Edinburgh was granted a royal charter in 1854. The first formal association of accountants in England was organized in Liverpool in 1870. The Institute of Chartered Accountants in England and Wales received its charter in 1880 and the Society of Incorporated Accountants and Auditors in 1885.

The Role of the Companies Act

One sometimes reads that the development of the profession in Britain can be traced to early companies legislation. This is not, however, entirely correct. The Companies Act of 1862 recognized a need for independent scrutiny of company accounts but it did not make an independent audit obligatory. The Act had attached to it a model set of company bylaws which required the appointment of auditors, but the adoption of those bylaws was optional. It was probably true

nevertheless that the majority of companies incorporated under that Act did engage independent auditors.

One should not attach great importance to British (or Canadian) companies legislation as a cause of change in matters touching accountancy; such legislation has seldom been the spearhead of an effective reform movement. Traditionally it has been a rationalization of standards to which a majority of those affected have already become reconciled. Quite apart from legislation there existed a rather obvious need for independent scrutiny of accounts where those in control of affairs were not those who were financing the enterprise, and the latter were incapable of checking things for themselves. The official sanction which the 1862 Companies Act gave to the appointment of independent auditors came after a number of painful experiences, such as the disastrous end of the railway boom in England in the 1840's.

The British Companies Act was amended in 1900 to require every company to have an auditor elected by the

¹ See Sir Laurence Halsey, "The Position of the Public Accountant in Relation to

Government and Business in Great Britain", The Journal of Accountancy, Aug. 1938.

shareholders. By this time the profession was well established in Britain. The statute merely required of all companies what had become a widespread practice.

The Social Inheritance

The British accountancy profession, developing at a relatively recent stage, was able to draw upon a number of social techniques which had been maturing in Britain for a long time. There was much in the ethics of the legal profession which could with some modification be applied to the accountancy profession. Before the accountancy profession was ever organized there existed a body of professional ethics which forbade competitive bidding among practitioners, advertising, and giving advice to clients when the practitioners had a pecuniary interest in the proposal. In Britain the accountancy profession never experienced an internal struggle to persuade its members not to advertise. It was easy by analogy to adapt the rules of the legal profession to accountancy: the public accountant ought not to recommend bookkeeping systems to his client and at the same time receive a commission from the supplier of such systems; and (in later years) the accountant ought not to undertake income tax work on terms that his remuneration should be a share of what he saved his client, any more than the lawyer should accept as his fee a share of damages secured for the client.

The accountancy profession in England also availed itself of an institution which went back to guild procedure—the "apprenticeship system". 2 Whatever may

be said for or against this system, it must be admitted that from a professional point of view it tends to make the incumbents a homogeneous group. And a homogeneous group is much more amenable to self-discipline and common ethical standards. and

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An additional factor contributing to the prestige of the profession in Britain was the tradition that the white collar worker has social distinction. One of the prerogatives of the professional man is that he should be allowed considerable latitude in exercising his discretion - in using his judgment. He needs prestige and the confidence of the public if he is to be allowed a wide area of discretion. English public accountants have for some time offered themselves for high public office and a number have been honoured by the Crown. T. H. Sanders tells of taking lectures at the University of Birmingham in 1902. The professor of Accounting was Lawrence R. Dicksee "who came down in the London express and a silk hat one day every week".3

Prestige of the British Accountant

The developments peculiar to Britain have meant that the public accountant there has been able to deal with individual cases on their own merits rather more than his counterpart on this side of the Atlantic.⁴ It has meant also that accounts which are audited by professional accountants in England are not questioned by government officials. The tax inspector does not have the legal right to examine the books of the taxpayer but he may request statements prepared by accountants.⁵ A copy of the audited fin-

² It is sometimes argued that the term "apprenticeship system" should be restricted to the trades, as distinguished from the professions, and that the proper term for the professions is "system of articling". It is doubtful, however, if the distinction is widely recognized in Canada and the United States.

³ T. H. Sanders, "The Training of Accountants in England", The Journal of Accountancy, Aug. 1924, p. 118.

⁴ See T. H. Sanders, "Accounting Principles —American and British", The Journal of Accountancy, Feb. 1945, pp. 113-114.

⁵ See Mary Murphy, "The Rise of the Profession of Accountancy in England", The

ancial statements of all public limited companies has to be filed with the Registrar of Companies but the Registrar acts merely as a medium for providing public access to the required information and does not question their content. High standards of professional conduct, if established early and rigidly maintained, are a defence against government intervention.

Some have said that the English auditor characteristically checks more detail than his American counterpart because the profession in England developed under the aegis of the Companies Act.6 The greater amount of detailed checking in England is of course, in so far as it exists, a reflection of the English accountant's ability to exercise a wide discretion in the amount of work he should do in each individual case; but the ability may derive as much from professional standing as from legislation. Furthermore, a greater amount of detail checking is feasible where an apprenticeship system operates.

The post-war change in the political temper of England as evidenced by the Labour governments has left its mark on the accountancy profession. There has been a tendency since the war to do away with the premiums which the person seeking to enter the profession had often to pay in the past, and there has been some experimenting with the training of articled clerks.7 Nationalization of industries has been a gigantic consolidation process and has tended to shift accounting work from the small firm to the large one and to emphasize internal auditing at the expense of external auditing. The audit of the British Transport Commission provides an impressive illustration of the accounting ramifications of state enterprise. The audit had to be done in parts by professional firms each relying upon examinations made by other professional firms. There were in all 130 firms of professional auditors appointed by the Transport Commission. The first annual report comprised 420 pages including 90 pages of accounts alone.8

THE DEVELOPMENT OF THE PROFESSION IN THE UNITED STATES

The first professional body of accountants in the United States was organized in 1887 (the American Institute of Public Accountants). The difficulties which beset accountancy in attaining a professional status were particularly marked in the United States. Possibly something of the aggressive, rough and ready "frontier" spirit which had characterized earl-

ier American development lingered to harass the professions.

Apprenticeship un-American

The apprenticeship system, by which prospective entrants to the profession were "articled" to a practising accountant for a required term of experience, was considered especially un-American and

Accounting Review, June 1940, p. 335; also John Myers, "A Century of Professional Accountancy", The Accountant, Feb. 24, 1934, p. 270.

See C. A. Moyer, "Early Developments in American Auditing", The Accounting Review, Jan. 1951.

⁷ See the Presidential Address (Sir Russell

Kettle), 69th Annual Meeting of the Institute of Chartered Accountants in England and Wales, *The Accountant*, 13 May 1950, p. 542.

⁸ See Mary Murphy, "Role of Accountants in the British Nationalization Program", The Accounting Review, Jan. 1952, pp. 69-70.

indeed a kind of serfdom. As a result it was difficult from the beginning to control the kind of experience which would qualify a person to practise as a public accountant. The demand for accountants developed quickly after 1887 and the recruits to the profession were either men who had graduated from the ranks of bookkeepers or men who had come over to the profession after years spent in commercial pursuits. There is an amusing story of the early days of American accountancy which will illustrate the point. About the time the first professional group was organized a meeting was held to consider the desirability of requiring accountants to pass examinations, and what subjects the examination might cover. One of the accountants suggested an ambitious curriculum including English, foreign languages, mathematics, and physics. the sound of the word "physics" another accountant present brightened up. know all about physics," he interjected. "I used to work in a drug store."9 The contrast with Britain is apparent.

Commercialization of the Profession

Those who came over to the profession from various commercial pursuits brought with them the rationale of commerce. They had had no indoctrination in the niceties of professional etiquette and were not especially amenable to discipline. They appear to have influenced the whole course of development of the profession in the United States. For them self-restraint was no virtue. There was competition among accountants and advertising. Advertising was an especial bug-bear. Even as late as 1927 the editor of The Journal of Accountancy (the publication of the national professional body) was chiding members of the profession on this score. He observed that "the old temptation lingers still and many good accountants like to listen even if they do not yield to the singing of the sirens." 10

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By English standards competition among practitioners is of course a most unwholesome professional trait; but in the American environment at the turn of the century it was at least understandable. In the United States there appear to have been no matured professional standards which could be drawn upon and adapted to the purposes of accountancy, as had been possible in England. Nor was there any Companies Act first to suggest and then to require an independent audit of public limited companies as there had been in England. The professional accountant in the United States had to offer his services solely on the basis of their utility to business. It was natural enough that there should be considerable competition for some time.

Different Emphasis on Accountant's Role

A bi-product of these developments is the difference in the approach of the typical British and the typical American auditor. In the United States auditors have had a somewhat greater incentive to produce the maximum of apparent results for a given cost and there has never been as much detailed checking. Accordingly the profession in the United States has led the way in devising means of sampling and testing so as to reduce the amount of time required in auditing the accounts; and in cooperating with management in devising systems of internal check within the client's business so as to justify less audit time. The tendency was accentuated as American business increased in size.11

J. T. Anyon, "Early Days of American Accountancy", The Journal of Accountancy, Feb. 1925, p. 87.

¹⁰ A. P. Richardson (Editor), The Journal of Accountancy, March 1927, p. 199.

¹¹ See C. A. Moyer, ibid, p. 7.

An essential point about the system of articling is that the employer has a recognized obligation to assist in the training of his protégés. Lacking the system, and having generally to engage employees at competitive salary rates, it was natural that the public accountant in the United States would not feel the same sense of responsibility towards his employees as if they had been under articles. As a result there has been considerable variation in the degree of preparation of candidates attempting the U.S. professional examinations. Moreover, in the earlier days of the profession, and during the twenties, a large number of accounting schools, offering correspondence courses, sprang up. They did not hesitate in their advertising to stress the high salary a qualified accountant might earn, and so tended to attract some who had not reckoned on honest effort as a prerequisite for passing the examinations.12

Decentralization of Professional Organization

The early organization of the profession in the United States was decentralized. The regulation of the professions comes within the jurisdiction of the individual states. New York State was the first to pass what is called "C.P.A. legislation". In 1896 that state required anyone who was to use the letters "C.P.A." after his name to pass a qualifying examination. This is the pattern on which the profession developed, state by state. Nearly all the states require some period of experience with a practising public accountant either as a prerequisite to sitting for the examinations prescribed by the "State Board", or at

least as a prerequisite to receiving the C.P.A. certificate.

Nineteen of the states have passed "restrictive" legislation, restricting the practice of public accountancy to qualified accountants. Many attempts at such legislation have, however, run into constitutional difficulties. Some state supreme courts have upheld "restrictive" legislation as constitutional on grounds that public accountancy was in the public interest and affected the public health, comfort, safety, or welfare; while the supreme courts of other states have not agreed and have ruled the legislation unconstitutional.¹³

The A.I.A.

Until 1916 membership in the national professional body of accountants in the United States was contingent upon one's being merely a member of a local state society. The national body did not have much scope for disciplinary action. In 1916 the American Institute of Accountants was formed with a view to establishing a system of direct, autonomous membership. The Institute proceeded to set its own examinations for admission, and has been able to persuade the various state boards of accountancy, one by one, to accept the Institute examinations as the qualifying examination for the CPA degree granted by the state.14 At the November 1952 sessions every state and territory of the United States, and the District of Columbia, gave the same examinations in auditing, accounting theory, and accounting practice to their candidates for the C.P.A. certificate. In 1952 also, a concerted effort was started to bring about eventual uniformity of education and experience requirements for the C.P.A. certificate.15 Membership in the Ameri-

¹² Editorial, The Journal of Accountancy, Mar. 1921, pp. 187-8.

¹⁸ Editorial, The Journal of Accountancy, Apr. 1926 (re decision of the Supreme Court of Illinois, 1926).

¹⁴ See Editorial, The Journal of Accountancy, Jan. 1926, p. 38.

¹⁵ See Editorial, The Journal of Accountancy, May 1952, p. 549.

can Institute of Accountants remains, however, a matter of individual application and there are many more practising C.P.A.'s in the United States than there are members of the national professional body. There are C.P.A. societies in every state, independent of the Institute but with a considerable over-lapping of membership.

Effect of Government on Profession

Commencing with the trust-busting era, and carrying through the legislation providing for income taxes in the first world war, and the Securities Act, the Securities Exchange Act and the Robinson-Patman Act of the 1930's, the prices and costs of individual businesses came more and more to be regarded as both government and public property. This trend has given the practice of accountancy more and more the flavour of a public interest. In Wangerin v. Wisconsin State Board of Accountancy (1937) the Wisconsin Supreme Court acknowledged the point in its decision: ".... We now have income tax laws, estate and inheritance tax laws, legislation on the sale of securities, blue sky laws, social security legislation, and unemployment insurance with payroll taxes, bank legislation, real estate brokers' laws, unfair trade practice acts, besides all the work done by accountants in the field of rate regulation, insurance practice, public utility rates, sale of securities, largely resting upon the reputation of the accountants who do the accounting, and many other aspects of the matter which make the whole subject of public accountancy a proper field for the exercise of the police power in the interest of the public welfare."16

Securities Control

The disillusionment following the

1929 stock market crash took the form of a public demand that something be done to regulate trading in stock. It was not by any means clear that the publication of any amount of financial information would have availed against the tide of optimistic speculation which preceded the crash; but after the crash there were many who were prepared to blame a lack of information for their plight. In March 1933 the Chicago Stock Exchange ruled that all further applications for listing of corporation securities be supported by financial statements certified by independent public accountants. The New York Stock Exchange made a similar rule in July 1933.

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The inception of the Securities and Exchange Commission in 1934 was a major event in the history of the profession in the United States. Through this agency federal control was extended to cover trading in existing issues on exchanges having an interstate clientele. As a prerequisite for listing on such an exchange, a corporation is required to furnish extensive information about its financial affairs in statements to be filed with the Commission and sent to investors.

The requirement that the financial reports to be furnished must be audited by independent public accountants was a boon to the profession in so far as it provided employment. What was of equal significance was that the S.E.C. was given power to prescribe accounting methods.¹⁷

The S.E.C. and the Auditor's Independence

The development of its own methods is a prerogative that any profession guards jealously. The history of the relationship between the profession in the

¹⁶ Editorial, The Journal of Accountancy, Feb. 1937, p. 90.

¹⁷ See E. M. Dodd, "Statutory Developments in Business Corporation Law", *Harvard Law Review*, 1936, pp. 27, 49-55.

United States and the S.E.C. appears to be one in which a modus vivendi was established largely on personalities. The chief accountant of the S.E.C. has traditionally been sympathetic and not disposed to impose blanket accounting rules over the whole diversity of business. Nevertheless this type of relationship, in so far as it exists, is a precarious one and there is evidence of some uneasiness of late.¹⁸

In 1937 the late and revered Robert H. Montgomery wrote, "If anyone outside the profession — governmental or private, client or friend — is stronger than we are and is able to tell us what to do, is able to influence a statement or a report against our best judgment, from that moment the profession will deteriorate." 19

The danger of a governmental agency like the S.E.C. to a profession is obvious. Perhaps the significant thing to date has been that the danger has acted as a stimulus to the profession. The S.E.C. technically holds the reins and if the practising accountant does not assert himself he will find himself being led in directions not always to his liking. The S.E.C. may refuse to file financial statements audited by public accountants on grounds that the disclosure is not adequate or that the accountant was not truly independent, and it has done so.20 If it refuses to accept the statements the securities must be withdrawn from trading on the stock exchanges. company, if it is to continue to operate,

has little alternative but to comply with the ruling of the S.E.C. and amend its statements.²¹

The accounting rulings of the Securities and Exchange Commission are numerous. The American public accountant has now to operate within a frame of reference which is considerably more complicated than his British or Canadian counterpart. The minimum disclosure of financial information in Britain and Canada is determined by the Companies Acts which are amended only at irregular and somewhat lengthy intervals; and there are no interpretive rulings issued under the Companies Acts.

Many American accountants have realized that the trend of government regulation which has provided so much employment for accountants is not an unmixed blessing if it robs them of their professional initiative. One of them put it this way: "There is a considerable difference between the master mariner on the high seas and the harbor pilot in a buoyed channel."²²

The S.E.C. has been a major force in stimulating the profession in the United States into its present vigorous and productive period. The committees on accounting and auditing procedure of the American Institute of Accountants have been continuously active in publishing research bulletins. One or two of the bulletins have been presented to the entire membership of the Institute for

¹⁸ See S.E.C. Accounting Series Release No.
73 (Oct. 30, 1952) in the Matter of Haskins & Sells and Andrew Stewart, and editorial in *The Journal of Accountancy* Jan.
1953.

¹⁰ R. H. Montgomery, "What Have We Done and How?" The Journal of Accountancy, Nov. 1937.

²⁰ See S.E.C. Accounting Series Release No. 68—Findings and Opinion of the Com-

mission to determine whether the privilege of F. G. Masquelette & Co. and J. E. Cassell to practise as accountants before the Securities and Exchange Commission should be denied temporarily or permanently, July 5, 1949.

²¹ A. A. Berle, Jr., "Accounting and the Law", The Journal of Accountancy, May 1938.

²² J. B. Scholefield, "The Robinson-Parman Act and the Accountant", The Journal of Accountancy, July 1937.

approval.28 The majority of the bulletins, though they do not have any direct compulsive force, nevertheless serve to encourage the most acceptable and to inhibit the least acceptable practices. It is probable that a U.S. court would look at the bulletins where a question arises about the generally accepted practice in the profession, and that the bulletins might influence a court in a case in which an accountant was the defendant. Thus the S.E.C. has brought recalcitrant minorities in the profession into line both directly and indirectly. It has done so directly through its rulings and indirectly through stimulating the profession into the publication of bulletins.

Price Regulations

Another instance of government regulation that added to the public responsibility of accountants was the Robinson-Patman Act of the later thirties. Act was intended to ensure that differences in the price quotations of a concern to competing customers were justified by economic considerations. Some of the larger concerns, such as chain stores and mail order houses, appeared to have a buying power which was out of proportion to the economies resulting from large orders.24 Whether the quantity discounts offered to large customers were supported by corresponding cost reductions for the supplier was a subtle problem the accountant was expected to be able to answer. The Act served to extend conventional cost accounting methods to the comparatively unexplored fields of administrative and marketing costs.

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The famous McKesson & Robbins scandal of 1939, resulting from an elaborate and ingenious fraud which had gone undetected by public accountants, had a profound effect upon the profes sion in the United States; and to some extent in Canada too, because some American concerns owned subsidiaries here audited by Canadian firms. United States the S.E.C. held extensive hearings on the case. There was a great deal of heart-searching in the profession about the adequacy of the usual audit techniques. The event coincided with the beginning of a series of bulletins published by the Committee on Auditing Procedure of the American Institute of Accountants. The first of these bulletins recommended a more extensive verification of inventories and accounts receivable than has been accepted practice in Britain and Canada.

In the past three or four years the American Institute of Accountants has been experimenting with vocational tests as a means of determining the adaptability of applicants for employment in firms of public accountants. Use of the vocational test may be considered in part as an attempt to provide one of the advantages of the system of articling without having the system: to encourage a certain amount of homogeneity of interest, outlook, and ability in the profession.²⁵

²⁸ Auditing Research Bulletin No. 1 (Extensions of Auditing Procedure) and No. 23. The latter "provides in substance that an independent auditor in his report should either express an opinion on the financial statements as a whole with or without exception, or should clearly state that he cannot express an opinion on the statements as a whole, and the reasons why". (The

Journal of Accountancy, June 1949, p. 452)

²⁴ See H. J. Ostlund, "The Robinson-Patman Act and Quantity Discounts", The Accounting Review, Dec. 1939.

²⁵ See R. G. Ankers, "Institute's Vocational Tests Assist in Hiring and Promoting Staff Workers", The Journal of Accountancy, Jan. 1951.

THE DEVELOPMENT OF THE PROFESSION IN CANADA

The form of the accountancy profession in Canada has been influenced substantially by British (particularly Scottish) tradition. British professional attitudes were imported when Scottish, and a somewhat lesser number of English, accountants migrated to Canada. In this sense the development of the profession in Canada was not native to our soil as it was in the United States.

In view of the relatively non-urban nature of the Canadian economy, at least until recently, professional accountancy bodies were established here at comparatively early dates. The Quebec Institute was incorporated in 1880, the same year as the Institute of Chartered Accountants in England and Wales and seven years before the American Institute of Public Accountants. An Institute of Accountants and Adjusters obtained an Ontario charter in 1883. There appear to be two reasons for the early organization of the profession in Canada. First there was the influence of the Scottish accountants who had had their own professional society in Scotland since 1854. Second, the Dominion Insolvent Acts of 1864, 1869, and 1875 called for "official assignees" to administer and distribute estates in bankruptcy.26

The C.I.C.A.

The Dominion Association of Chartered Accountants (now re-named the Canadian Institute of Chartered Accountants) was established in its present form in 1910. It had, in fact, been granted a federal charter in 1902 upon a petition of some accountants who had not approved of the way in which the af-

fairs of the provincial Institutes were being conducted.27 However, it was never able to enter a period of active competition with the provincial Institutes because of the constitutional difficulty that the granting of educational powers comes within provincial jurisdiction. Accordingly a major policy change in 1910 called for cooperation with the provincial Institutes. At that time there were already provincial Institutes in Quebec (1880), Ontario (1883), Manitoba (1886), Nova Scotia (1900), British Columbia (1905), Saskatchewan (1908), and Alberta (1910). Since then the provincial Institutes of New Brunswick, Prince Edward Island, and Newfoundland have joined.

Membership in the Canadian Institute of Chartered Accountants has always been by virtue of one's being a member in a provincial Institute, and the Canadian Institute simply comprises representatives from the provincial Institutes. The disciplining of members remains exclusively a provincial matter. (This arrangement is in contrast with the organization of the profession in the United States, where membership in a state C.P.A. society does not automatically bring membership in the American Institute of Accountants, and where the American Institute has separate disciplinary powers over its own members.)

The purpose conceived for the Canadian Institute of Chartered Accountants in 1910 was to provide a means of cooperation between the provincial Institutes and to secure uniform standards of examinations throughout the country.²⁸

²⁶ See R. R. Thompson, "The Development of the Profession of Accounting in Canada", The Canadian Chartered Accountant, March 1939.

²⁷ ibid.

²⁸ See F. B. Hurdman, "Accountancy in the United States and Canada", The Journal of Accountancy, Nov. 1928.

Uniform intermediate and final examinations were instituted in 1939. The Canadian Institute also publishes *The Can*adian Chartered Accountant and its Committee on Accounting and Auditing Research has issued bulletins periodically commencing in 1946.

Apprenticeship System

The Canadian profession is based on a modified version of the system of articling. Premiums have never been payable by students-in-accounts upon articling and indeed a majority of the provincial Institutes do not regard their students as being under formal articles. On the other hand students in all Provinces have generally been paid somewhat less than the going rate of salary for accounting work in industry (though there is some evidence of late that the differential is narrowing). The ratio of students-in-accounts to qualified accountants in the professional firms is generally subject to scrutiny and the employing accountant has a recognized obligation to assist the student in his training, to provide him with a variety of work, to keep in touch with the progress of the student in his course of instruction, and to avoid giving him excessive work at examination time.

While the profession in Canada owes much of its form to British professional attitudes, the approach to specific problems in Canada is now much more influenced by American thinking than by British thinking. In particular there are two reasons for this result: first, the vigour of the American profession in its research activities, and, second, the fact that a number of large Canadian companies are subsidiaries of U.S. companies with the audit of both parent and subsidiary being performed by international firms with offices in both countries. But whether the Canadian development has been eclectic, borrowing the best from each of Britain and the United States, or merely hybrid, is a question most Canadian accountants will decline to answer out of modesty.

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The Purpose of Professional Auditing

By Alfred F. Gosling, C.A.

The auditor's first responsibility is to the public interest, which he serves in various ways

THEN we use the term "professionional auditing" we think of a firm or individual whose full time occupation is the auditing of the books of account and who holds himself out for public engagement. What are some of the underlying principles of professional auditing? In referring to the dictionary definition of the word "professional" we find the following: "employed by the public generally and so makes a profession of his work", "opposed to amateur", "indicated high standard", "characteristic for conforming to the standard of a profession". Note that these definitions emphasize a high standard or expert knowledge.

Expert Hearing and Advice

The word "audit" is derived from the Latin "audire" — to hear, and an audit in its earliest conception was a hearing. Now if we combine these two definitions we get "an expert hearing" or a "hearing by one of high standard".

Would you not say that the foregoing definitions suggest that if one is engaged in expert hearing then he will be rendering expert advice? In other words the professional auditor is not only engaged in the auditing of books of account but in giving expert advice to the public on various matters pertaining to audit and financial matters.

I think it is important that we understand the difference in the term "audit" as distinct from "accounting". In its strict interpretation as applied to books of accounts, an audit is the examination of prepared financial data without further compilation by the auditor. In other words, a set of financial statements is handed to the auditor with instructions for him to verify its accuracy. But, alas, how many times does this state of affairs exist? All too often the auditor is called upon to prepare all the financial statements after making a check of the books of account. In so doing he has performed an accounting service and not an audit in its strictest sense. An editorial appearing in the May 1953 issue of The Journal of Accountancy, the official publication of the American Institute of Accountants, makes reference to this matter by posing the question, "Is the term 'audit' too loosely used?" This editorial

states that objections have been raised to the growing use of the term "audit" in conjunction with investigations or surveys of business such as management audit, efficiency audit, insurance audit, also medical audit, which do not involve examination of books of account.

Later I will refer to some of the particular aspects of professional auditing, but first let us consider some of the fundamental rules or cardinal points in professional auditing.

The Public's Claim

Earlier, I referred to the public engagement of the professional auditor. In carrying out a professional audit it is well to consider whose interest should be uppermost in the thought of the auditor—the public, the client, or the profession. This problem is approached quite differently by auditors generally.

Because the auditor is engaged by the client, some suggest the client's interest should be served at all times. On the other hand, in matters of principle it is sometimes suggested that the cause of the profession should prevail over that of the client. But in the last analysis the interest of the public is the one that should motivate the thoughts of the professional auditor at all times. As professional auditing holds itself out to the public for engagement, the ultimate responsibility is to the public. John L. Carey refers to this matter in his book "Professional Ethics of Public Accounting", and lists the rules of professional conduct in the order of importance as follows:-

- 1. The interest of the public
- 2. The interest of the client
- 3. The interest of the profession.

It may be said that fundamentally professional auditing is the serving of public interest in general and the individual in particular.

Economic Function

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It is important to understand that the professional auditor performs an essential economic function. A government of today is vitally interested in the economics of the country's welfare and leans very heavily on the advice of the economist in setting financial policies. Webster's dictionary defines "economics" in part as "the science that investigates the conditions and laws affecting the production, distribution, and consumption of wealth".

The professional auditor fits right into this definition, for his essential function is the dissemination of financial data which he images forth by word pictures (reports) and figure pictures (financial statements). Thus the professional auditor is able to interpret to management the results of trading, in such form as will be understandable and intelligible.

Business management is realizing more and more the importance of the contribution to be made by the professional auditor through his ability to investigate problems affecting production, distribution and consumption of goods. It is perhaps appropriate to quote from Montgomery's "Auditing — Theory and Practice":—

The importance of the work of the auditor in the conduct of business and in the maintenance and development of our social and economic structure is now generally recognized. Its character demands specially trained men of the highest integrity and ability.

Independence

Another fundamental aspect of professional auditing is independence. By that I mean the giving of an unbiased opinion, or an opinion given completely free from personal or internal influences. This is one of the professional auditor's most cherished characteristics. Independence has been stressed time and time

again by the professional writer and thinker. By expressing independence the professional auditor engenders public confidence in both his oral statements and written work. This matter of independence is of such importance that I should like to quote you from a paper given by Mr. John L. Carey, C.P.A. at the Second Inter-American Accounting Conference at Mexico City:

(1) The professional accountant acting as an independent auditor accepts the obligation of maintaining independent and impartial judgment in his examination of accounts and in expressing his opinion on financial statements.

(2) He will disclose all material facts which he discovers that have a bearing on the financial position or the results of operations.

(3) He will conduct his examination of accounts in accordance with generally accepted auditing procedures and not express an opinion on financial statements unless he has made an adequate examination.

(4) He will not have any substantial financial interest in the affairs of a company on whose financial statements he is reporting without fully disclosing that interest.

(5) He will not render an opinion on financial statements under circumstances in which the amount of his fee depends on the successful outcome of any venture in which those financial statements may play a part, such as the issuance of securities.

He may fairly represent his client in negotiations with government agencies, income tax departments, banks, investment houses and the like, with an open mind not influenced by any personal factors or extraneous pressure, but with a sincere desire to see justice brought about.

Fraud

There is a well known proverb that says "prevention is better than cure" and

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prevention of fraud is of prime importance in any business. The professional auditor makes a large contribution in this direction. As Mr. Montgomery puts it, "Employees who know that their work is to be scrutinized and reviewed by an auditor are much less likely to violate the trust that has been placed in them, than are those who never expect enquiries into their activities."

In giving judgment in the case of Armitage v. Brewer & Knott the learned judge said, "It is the duty of auditors to be suspicious; that is what they are there for."

However, the auditor should approach his duties with a desire to achieve an objective or assignment with a spirit of cooperation, and not with the "policeman" approach, regarding all and sundry as potential law breakers.

The engagement of the professional auditor therefore materially assists in the prevention of fraud.

Internal Control

Possibly the most effective means of preventing fraud is an adequate system of "internal control" — a phase of accounting that is of the utmost importance.

As its name implies, internal control is the control of goods and property from within a company whereby the work is subdivided among the clerks so as to provide a check on each other.

In his book, "Auditing", Professor

Smails points out that the installation of an efficient system of internal control is a means of avoiding the following matters:—

(a) Fraud and deception

(b) Clerical inaccuracy

(c) Errors of principle due to ignorance of accounting theory

(d) Presentation, in good faith, of misleading statements based on records which are themselves correct.

In larger companies it is quite usual to have an internal audit staff, whose job it is to carry out continuous checks of company records and supplies throughout the year.

In setting up the system of internal control and planning the program for the internal audit staff, the professional auditor is frequently asked to advise his client in this regard and works very closely with company officials.

Knowledge of Subject

It is also of fundamental importance that if management is going to be encouraged to request the services of professional auditors, it must have confidence in the ability of the auditor to carry out his assignment in an intelligent and economical way.

To achieve this objective the auditor must have a thorough knowledge of the subject upon which he is required to report. The professional auditor by virtue of his training and experience is eminently suitable to inspire management to have confidence in him.

People have many ideas as to the purpose of professional auditing and if you were to ask the average individual what function the professional auditor performs he would most probably reply, "the preparation of income tax returns or financial statements for income tax purposes". What a limited outlook, when

such fascinating services are rendered as, for example, investigations for the purchase of a business, for the application of a bank loan, for exposure of fraud, audit for prospectus purposes on the issue of shares to the public, assisting in the establishment of internal control, setting up costing systems, systemization of accounting generally, and, of course, statutory audit.

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Investigations

Before purchasing a business the prospective purchaser wishes to satisfy himself that it is a sound investment. He can examine the physical quantities of the business - inventories, real estate, equipment, etc., but he needs to know how effectively these items have been put to use in the past and what the future potential is with them. To ascertain the accuracy of this function he engages the service of a professional auditor to investigate the accounting records and report thereon. After receiving the auditor's report of past activities, the prospective purchaser then is able to estimate future potential, and decide whether to proceed with negotiations for the purchase of the business or to let the matter

I mentioned above the professional auditor's function in the prevention of fraud. Should it so happen that management does suspect that fraud is taking or has taken place, the auditor is called in to make an investigation to determine the causes, reasons, amounts, and, if possible, persons responsible.

When a prospectus is to be prepared for the issue of shares to the public the professional auditor is engaged to prepare a statement of earnings of the business for a minimum of the previous five years. This is not just the normal preparation of an earnings statement but requires scrutiny for consistency of presentation and the elimination of non-recur-

ring and other items in order that a true statement of earnings may be presented. A pro forma balance sheet showing the projected position after the issue of the share may be required in addition to the last audited financial statements. This work carries a great deal of responsibility because the public will be influenced to invest its money partly on the strength of the financial report contained in the prospectus.

Systems

Business today is becoming more and more competitive. Methods of production are improving all the time but in a great many instances the methods of keeping books of the business often stand still and become either out-ofdate or unwieldy. Again, with increased competition there is greater need for the ascertainment of the costs of production and measures of efficiency. The corrective measures for these problems are more often than not beyond the scope of the existing staff, and the professional auditor is asked to review the requirements and to install a cost system or revise the accounting methods. There is tremendous scope in this particular phase of work because not only is the need so great, but also because it gives one a great deal of satisfaction to see the salutary effect brought about in the business and on its personnel as the result of his work. Improvements in accounting systems and the creation of cost systems can relieve the management

of a great deal of anxiety and also earn their gratitude.

Statutory Audit

As its title implies, the statutory audit is one that is required by regulations or governed by them. For example, a company incorporated under the Companies Act and governed accordingly must have a yearly audit and disclose certain information in its financial statements. The Bank Act and regulations ancillary thereto require public audit and report, and regulations stipulate certain verifications the auditor must perform. Municipal Acts make specifications concerning the audit of civic affairs; trust companies and insurance companies are further examples of statutory audits. The professional auditor performs an extremely important function to the public as a "statutory auditor".

When engaged on a statutory audit the professional auditor has a heavy duty and responsibility to the public, because the public is vitally interested in receiving a correct and accurate statement of stewardship, and their only contact or report thereon comes through the statutory audit.

I have endeavoured to review some of the factors regarding the purpose of professional auditing. However, in the final analysis the principle function of the auditor is professional service with a capital "S". That is one of the most important factors to success for both the client and the practitioner.

A Recent Book

A Standard Classification of Municipal Accounts, published by the National Committee on Governmental Accounting of the Municipal Finance Officers Association, Chicago; pp. 116 and appendices; price \$3.00

This book, which is the result of a study by the National Committee on Governmental Accounting, with headquarters in Chicago, Illinois, is a comprehensive survey of the classification of municipal balance sheet and of revenue and expenditure accounts. It is designed to serve as a basis for accounting, budget-making, administrative control, and the compilation of financial statistics. It can be adapted for use by municipal authorities or other forms of local government. One great advantage is that such a classification will enable municipalities to report on a uniform and comparable basis. The increasing spending and scope of the activities of local governments makes such uniformity highly desirable.

The book is divided into four parts. Part One deals with the advantages of the recommended classification and explains the theory of its application. Part Two is a comprehensive review of the various balance sheet accounts and explains in detail the items to be included under each heading. Parts Three and Four review the recommended grouping of revenue and expenditure accounts and give in detail the theory of the suggested grouping of them.

The authors are to be commended for the publication of this study, which should prove extremely useful as a guide for those charged with the responsibility of the administration and financial control of municipalities and other forms of local government.

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Books Received

Key to Income Tax and Surtax, edited by Ronald Staples; published by Taxation Publishing Co., London, pp. 222; price 7/9

Here are to be found the new provisions of the Finance Act 1953 as well as full references to the Income Tax Act 1952. An automatic thumb-index enables the reader to find his reference in five seconds, or so the publishers claim.

Common Stock Values and Yields, Michigan Business Studies, Vol. XI, No. 3; published by the School of Business Administration, University of Michigan; pp. 35; price \$2.25 (paper), \$2.75 (cloth)

This is a brief statistical treatise of the performance of common stocks on the market today and of the various factors which influence that performance.

Is the Current Student Training Course Appropriate?

By E. W. Thompson, B.A., C.A.

What are the requisites of a good correspondence course for accounting students?

THERE are three principal requirements for entrance into the profession of accountancy:

- 1. General educational standing,
- 2. Practical experience,
- 3. Passing an examination.

The course is concerned with only the last item - the passing of the examination. If it were concerned with postexamination activities there would have to be an attempt to train students for specialized fields - government, municipal, cost, mining, taxation - and we would have some form of annual supplement to bring the training up to date each year. If the course were designed for the practice of public accounting we might perhaps modify it along the lines of the advice said to have been given to young John A. MacDonald by Hugh MacKenzie to whom the former was then articled. When John A. was being sent to open a branch office for his employer, MacKenzie instructed him:

- Never talk business without receiving a fee in advance.
- 2. Be assiduous in getting briefs.
- 3. Be industrious in doing them.

When John A. mumbled something

about "law", the older man snorted, "The rest is a lot of red tape — it's all in the books anyway."

Inspiration

An idealistic view of education might include an inspired instructor, intelligent students eager to learn, an extensive library, unlimited time, and no financial worries.

It is a far cry from that to the cold print of a course laboured over by tired students, with a library consisting of texts and lesson sheets.

Not all instructors are inspired. A good instructor should suggest rather than insist, encourage rather than dominate, give his students the desire for knowledge and the love of ideas rather than presume to give knowledge itself. These things will last when the material of the course is forgotten.

The attributes of a good instructor may perhaps be listed as:

- Systematic organization of material,
- Ability to explain the matter clearly,
- 3. Expert knowledge of the subject,

- 4. Ability to encourage thought,
- Enthusiastic attitude toward the subject.

These five attributes were most frequently mentioned in a survey of 6,600 students recently taken in the United States.

These attributes can be keyed down as:

- 1. Organization,
- 2. Clarity,
- 3. Knowledge,
- 4. Inspiration.

There would seem to be little value in discussing whether students would have better success under the lecture system than under the correspondence course method until full training courses for the C.A. examination are available, and until we have settled the merits of training students on the job, as against giving technical training at colleges and following it with some form of interneship. The best that we can now do is to check the correspondence course against the good instructor.

Combining the attributes of a good instructor with some characteristics of technical college training, we might make up some such list as follows. We should have:

- 1. Organization,
- 2. Clarity,
- 3. Knowledge,
- Inspiration on the part of the instructor and students,
- 5. Library,
- 6. Compulsory attendance and study,
- 7. Solution of student problems by personal contact with the instruc-
- 8. Course content optional subjects.

The Correspondence Course

Let us examine the correspondence course as we know it in the light of this list. Some of the items can be grouped. Organization, clarity and knowledge are very closely linked. Clearness and simplicity of explanation come only from a full understanding of the subject and an orderly mind. All subjects are comparatively simple, all subjects are interesting. We suffer greatly from stumbling, complicated, and uninterested people.

Every effort should be made to make the course interesting. Short historical introductions, if well written, provide understanding and arouse interest. The facts that the net worth assessment method often used by the Tax Department was used centuries ago in Babylon and Egypt for much the same purpose, that the standard of living method of assessment was a favourite device by Henry VII of England, that venture accounting was used by the Salem merchants and the China Tea Clippers, provide a little light relief and remind the student that the course is a practical one used daily by businessmen and not dreamed up in the night watches by some pedantic scholar.

In the matter of organization it might be well to rearrange the lessons so that instead of jumping from subject to subject for no particular reason, the year's work in one subject is covered before starting on the next subject. It is done with cost accounting (6 short lessons) and income tax (2 lessons) and might well be done in other subjects.

If references are made to a certain section of a text book or lesson for further explanation of a certain topic, the references should be fully detailed, e.g., "Lesson 6, second year, pp. 2 - 3" — never just "See Lesson 6".

Out of date references — such as "see The Canadian Chartered Accountant for May 1935" — should be reprinted if essential. Few practitioners and fewer students have access to such references. The reading list, when referring to additional reading sources or material not supplied

with the course, should clearly state whether these are optional, desirable, or compulsory reading and briefly state why. Additional reading recommended by a university instructor is either available in the university library or placed on the additional reading shelf for the course, but it should not be assumed by the writer of a correspondence course that the student has access to any library or that he will rush out to spend \$10 or \$20 every time the course prints another title at the head of the lesson. Here the student association library can serve a real purpose. Build up a good library, keep it alive by constant additions, make it free to circulate. Never mind the mahogany book cases and locks. Pine board shelves and circulating books are much more useful. Some books will be lost, but better a read, lost book than a locked, unopened book. Some form of annual contribution by students and C.A.'s alike, or even a professional library with all having access to it might well be established. Students should get into the habit of reading outside the prescribed course. I am still reading to find out what my clients think I already know.

Need for "Iron Will"

For the compulsory attendance at lectures the student must substitute his own "iron will"! The course, whether given personally by the instructor or impersonally through the mails only indicates a path along which the student may travel if he will. There is no compulsion, but the price must be paid — either in hours devoted to study or in failure at the examination. Each course agreement is a contract between student and instructor wherein each agrees to do his part to reach an agreed destination, namely the passing of an examination. A onesided agreement is no contract. The instructor agrees to guide, the student agrees to follow.

Mr. E. W. Thompson, B.A., C.A. was graduated from Mount Allison University in 1945 and was admitted to the New Brunswick Institute in 1950. He is a resident partner for Fredericton of the firm of Lee & Martin, Chartered Accountants.

Reading habits are important because no personal explanations are possible. The reader must find out what the writer said. Hence, the importance of the clearness of expression of the writer and the discovery of the meaning by the reader. Food for the body is sold by weight. Text books tend to be sold by the page.

For instance, 632 pages by Professor Pad, "Higher Accounting for Lower Students" plus an index, plus a ten-page list of additional reading matter - all can be bought for \$7.50! The student often finds considerable trouble in extracting the bones from the padding and I believe that most students would benefit from summaries of the dry bones. Some readers may be familiar with a series of small books going under the general title of "Nutshell". I believe that a "Nutshell" series for accounting students would be worthwhile. Reading speed is important. The Mutual Life Insurance Co. of New York is endeavouring to increase executive productivity by 25%, according to the May 1953 issue of Canadian Business, by a 15-hour reading course. The idea is that the executive can save two hours a day by doubling his reading speed. The article states that "reading speed at the beginning of the course is about 275 words per minute and at the finish, speeds range between 420 and 800 words per minute". It might well be that if you want to gain time for extra reading, entertaining the girl friend or seeing your wife as the case may be, the solution is to increase your reading speed.

Finding the Answers

Correspondence between student and instructor on the solution of individual difficulties is often useless. Generally the student is unable to get his point across and the instructor unable or unwilling to realize what the difficulty is. Student meetings can do much to help, but the basic remedy is for the student to solve his own difficulties by more careful reading and sometimes by extra reading on and round the subject he finds particularly difficult. The course could provide great help for the student working alone by printing specimen answers to all questions included on the lesson papers. Under the present mailing system, such a specimen set could be mailed back to the student when his lesson paper is returned. There are difficulties. Some students might copy, for unless the course was changed each year such solutions could be passed on. Our present system does not prevent the exchange of lesson papers among students if they are so minded. Where more than one solution or treatment is possible these can be indicated. I do not mean that the solution provided would be the only solution, but that one of this standard would mean an "A" grade. Page references to textbook or course notes should form part of the answer so that the student could reread the matter if his answer was unsatisfactory. If the question demands an answer of the discussion or essay type, then the specimen answer could consist of a list of points which might be mentioned in the answer. All subjects can be treated in this manner. After all, if such a specimen, passing answer cannot be framed by the instructor setting the question, why expect the student to be able to do so?

The same thing applies to the Institute examination questions. Specimen answers to all of these should be published in booklet form at least two months before the next examination. Passing grade specimen answers should be promptly available to all students, primary, intermediate and final, in all papers, so that those who have failed may have a chance to see their faults and newcomers may have something to aim at. Textbook or course references should also be a part of these answers.

Look at the Syllabus

The content of the course is, I have suggested, designed to enable the student to pass an examination for which the syllabus has been laid down. The content of the course can thus be assessed fairly only as to its coverage of the syllabi for the various examinations. As far as my limited knowledge goes, I think this has been done but I believe that a copy of the syllabus of the examination for which he is enrolling should be sent to the student with his enrolment form. The final responsibility of preparing for the examination rests with the student and he would be well advised to check what he has studied against what he may be examined on.

If the examination is to be regarded as a qualifying one to show that all students have reached a specified minimum standard before being allowed to use the letters "C.A." then not much can be done in the way of options. If we are all going to reach the same basic standard before going on to something else there would seem to be only one road to travel.

The Thorniest Criticism

I have left until last the most thorny of all the criticisms of "The Course." What substitute do we use for the inspiration of the inspired instructor, the magic of the personal contact, the thrill of the university halls, or the co-ed, and the awed tiptoe with which we envision in the library the recorded dreams and work of men? How can we get behind

the cold front of the two-cent stamp and the printed envelope?

You the student provide this by your self-dedication as you begin the course and by your renewed dedication as you commence the study for each new step.

The answer is boldly printed on the last page of the cover of this conference

program. If you will permit me to quote a little from it, you will see how you provide both the inspiration and the power to continue your quest.

I do not choose to be a common man.

I want . . . to dream, and to build, to fail and to succeed . . . It is my heritage to think and act for myself . . .

A Letter from a Reader

Montreal, October 7, 1953
ROAD TO BANKRUPTCY

Sir: Practising accountants have become cognizant of the fact that businessmen in general have gone all-out in their desire to make non-taxable gains, and to minimize as much as legally possible their taxable income. Licensed trustees in bankruptcy are aware of the fact that businessmen's desire to make non-taxable gains and to minimize taxable income is responsible for 50% of the bankruptcies that have taken place since the inception of the War Profits Tax 1914, and the Income War Tax Act 1917.

The underlying and apparent causes of bankruptcy are—

lack of business, lack of business experience, fraud in business, avoidable disasters in business, income taxes and inflation.

Businessmen will neglect their businesses when they realize that their earnings will be taxed to such an extent that they will have very little cash left after taxes to make investments in new buildings, new plant, new lines, and up-to-the-minute research. Fair and unfair competition compels businessmen to make new investments, if they desire to carry on successfully in their business.

Unless businessmen can make untaxable gains and minimize their taxable income, they are compelled to go into debt in order to carry on. Therefore, to assure their independence and their freedom of action from bankers and other creditors, they neglect their businesses to search for forms of investment and speculation they feel will give them the untaxable gains and cash necessary for essential growth and expansion. Such effort on the part of businessmen compels them to neglect their business, thus preventing them from keeping up with the times and gaining the necessary managerial experience that domestic and foreign competition requires.

This lack of experience in their lines results in inadequate sales, heavy operating expenses, large inventories and small receivables. With business neglect and inexperience, businessmen attempt to save themselves from failure by improper record-keeping, by the preparation of false financial statements, premeditated overbuying of merchandise, and irregular disposal of merchandise.

The cash gained through the disposal of merchandise in irregular channels is dumped in the stock markets and in real estate, hoping against hope that the stocks will rise and the real estate values will increase so that nontaxable capital gains will be earned. The spirit of inflation is increased, bringing disaster in its wake in the form of employee strikes, employee embezzlements, burglary, and arson.

In an attempt to stop the spirit of inflation, the government has allowed Canada to become the dumping ground of foreign merchandise, thus bringing certain industries to the brink of bankruptcy; and the government has further aggravated the situation by lifting the credit curbs.

To carry the large amount of instalment accounts on their books, industries have had to mortgage their properties through the sale of bonds to the public at rates of interest that must reduce earnings. This in part accounts for the fall in the value of stocks listed on the markets.

There is but one sure and only cure to save the nation from bankruptcy, and that is for the Federal Government to reduce income taxes on individuals and corporations by 50%, and to tax all income howsoever earned. Only through such a tax adjustment will the health and wealth of the nation be improved, and inflation, the bane of our national economy, be finally arrested.

M. GOODMAN

Obituaries

Rev. Brother Leopold (Mailhot)

The Institute of Chartered Accountants of Quebec reports with profound regret the death of Reverend Brother Leopold, former professor of accounting at the Faculty of Commerce of Laval University.

The death of Reverend Brother Leopold, who was accidentally killed in an automobile accident when returning to Quebec City, has brought sorrow to the hearts of his fellow members and confreres. Laval University is mourning the loss of one of its foremost professors of accounting and the students will greatly miss a competent and patient teacher and a kindly friend.

The Reverend Brother Leopold rendered valuable services to the Institute as a member of the Board of Examiners and was held in high esteem by his fellow members on the Board. In his sudden and untimely death the Institute has suffered a major loss.

The Council and members of the Institute wish to extend to the members of his family their heartfelt sympathy and condolences.

Clarence A. Patterson

The Institute of Chartered Accountants of Ontario announces with regret the death of Clarence A. Patterson at Niagara-on-the-Lake, on Sunday, November 8, 1953, after a brief illness. Born in Montreal, Mr. Patterson received his education in Toronto and graduated from Harbord Collegiate. He then entered the firm of Clarkson, Gordon and Dilworth, and became a chartered accountant in 1922. He was very active in Institute affairs and was made a Fellow in 1939 for distinguished services to the profession.

He served on Council from 1940 to 1946 and was president of the Institute for the year 1945-46.

After he qualified, he remained with the same firm and became a partner in 1935. He was one of the senior partners at the time of his death.

To his wife and family, the president and Council extend their sincere sympathy.

Professional Notes

News of the C.I.C.A.

COMMITTEE ON THE BANK ACT

Meetings of both the Toronto and Montreal sections of the Committee on the Bank Act were held during July and September. Their joint report is now almost complete and will be ready shortly for submission to Federal Government authorities.

TAXATION COMMITTEE

This committee, previously known as the Legislation Committee, has had its terms of reference widened to include all federal taxation matters, not merely income tax. Recently, provincial Institutes were sent a brief on pension plans for the self-employed. This was designed to provide the Taxation Committees of each Institute with the material necessary to enable them to consider the subject and make their recommendations to the C.I.C.A. Taxation Committee. The committee hopes that provincial Institutes will have suggestions to make on subjects such as succession duties and the sales tax in addition to the usual annual recommendations on income taxes.

COMMITTEE ON

RECRUITMENT AND TRAINING

The Committee on Recruitment and Training met on September 17 and October 14, 1953 to review the work that has been done on the analysis of replies to the questionnaire to students which was distributed in July.

MEETINGS

C.I.C.A. President W. J. Macdonald spoke to 1,500 delegates attending the 66th annual meeting of the American Institute of Accountants in Chicago. The subject of his talk was "Canada — a Challenge to the Profession". Delegates were given a small map

of Canada showing its main geological divisions to illustrate the main points in Mr. Macdonald's address.

Executive Secretary C. L. King and M. I. Pierce, Editor of *The Canadian Chartered Accountant*, played leading parts in a seminar conducted on October 14, 1953 by the Institute of Business Administration, University of Toronto. The subject of their talk was "Are the tax laws having an unfavourable influence on business accounting?"

ALBERTA

Mr George C. Berge, B.Com., C.A., announces the opening of an office for the practice of his profession at 117 LaFleche Bldg., Edmonton.

BRITISH COLUMBIA

Joint B.Com.-C.A. Course in B.C.

A joint committee of faculty members of the University of British Columbia and members of the B.C. Institute, established in 1952 to study the possibility of arranging a program which would permit a student to graduate as a chartered accountant and Bachelor of Commerce concurrently and without duplication in his studies, has now formulated the following plan, which it is hoped will go into effect in 1954.

Under the plan agreed on:

- A student will work alternately in his principal's office and at the University over a period of approximately 7 years after junior matriculation (university entrance standing).
- Subject to the provision that the student must spend one "winter" session at the University, the "academic" training will be intermeshed with the "practical" training on the basis of eight months in the

principal's office, September to April, and four months at the University, May to August.

- 3. The Institute will be responsible for the student's training, both academic and practical, in Accounting, Auditing, and Law, while the University will provide the other courses necessary to the granting of the degree of B.Com., such as English, Economics, Statistics, etc. Of the 81 units of credit required by the University for the degree, 18 will be granted for passing the final uniform examinations of the Institute, 18 for one winter session at the University, and 9 points for each of five summer sessions.
- 4. On passing his final uniform examinations the student will be granted the dedegree of B.Com. by the University if he has the necessary additional credits. With his B.Com. and a minimum of three years service under articles, the student will be eligible for membership in the Institute.

It has been a requirement of the B.C. Institute that before writing the final examinations, a student must have served continuously in a C.A.'s office throughout the required term of articles. In order to provide for the "C.A.-B.Com." students, the Institute's by-laws have been amended to enable Council to permit the suspension of articles while the student is attending the University. This may also result in summer work in C.A.'s offices by ordinary Commerce undergraduates being allowed as service under articles.

At the present time the plan, which has been approved in principle by the Institute, awaits the approval of the Senate of the University of B.C. When this approval has been granted, a joint standing committee of the University and the Institute will determine the detailed arrangements and, it is hoped, will have the plan in operation by the summer of 1954.

We see many advantages of this plan, the basic ones of which are:

- 1. From the standpoint of the student-
 - (a) an opportunity to obtain his B.Com. and C.A. in a shorter period than is presently possible,

- (b) elimination of some duplication in his studies,
- (c) meshing of the academic and practical.
- From the standpoint of the University better utilization of the University plant and personnel.
- From the standpoint of the member in public practice—
 - (a) increased supply of students because of the attractions referred to in 1 above.
 - (b) better balance in staff as between the busy and "slack" periods of the year.

Peat, Marwick, Mitchell & Co., Chartered Accountants, 410 Seymour St., Vancouver, announce the admission to partnership of Messrs. H. E. Kelly, C.A., D. W. Smallbone, C.A., J. A. Sutherland, C.A., and N. S. Vallance, C.A.

Mr Philip F. Dockerill, C.A. announces the opening of an office for the practice of his profession at Rm. 203, Crown Bldg., 615 W. Pender St., Vancouver.

Mr Donald H. M. Ross, B.A., B.Com., C.A., announces the opening of an office for the practice of his profession at 688 No. 3 Rd., Lula Island, Vancouver.

MANITOBA

Sharp, Woodley, Scott & McLaughlin, Chartered Accountants, Winnipeg, announce the admission to partnership of Mr Donald M. McConnell, C.A.

ONTARIO

Riddell, Stead, Graham & Hutchison, Chartered Accountants, 66 King St. W., Toronto, announce the admission to partnership of Mr John K. Hill, C.A.

Messrs Joseph Kerzner, C.A. and Jules Kofman, B.A., C.A. announce the formation of a partnership for the practice of their profession under the firm name of Kerzner, Kofman & Co., Chartered Accountants, with offices at 1016 Eglinton Ave., W., Toronto.

ONTARIO

Mr Ford W. Fredenburgh, B.Com., C.A. announces the admission to partnership of Mr Donald Snell, C.A. and the removal of his offices to 215 Victoria St., Toronto.

Ampleford, Craig & Broadhead, Chartered Accountants, 80 King St. W., Toronto, have announced the withdrawal from partnership of Mr G. Harold Craig, C.A. Practice of the profession is being carried on at the same address under the firm name of Ampleford, Broadhead & Co., Chartered Accountants.

Arthur A. Crawley & Co., Chartered Accountants, announce that Mr W. Benjamin Bolton, C.A. has been appointed resident partner of their Sudbury office.

Hamilton and District C.A. Association

On October 1 the Hamilton and District Chartered Accountants Association held its opening dinner meeting at the Royal Connaught Hotel. A panel of five members under the chairmanship of W. G. Thompson, C.A. discussed accounting problems arising out of the income tax laws. R. B. Taylor, C.A. presided at the meeting.

Pettit, Hill and Bertram, Chartered Accountants, announce the admission to partnership of Messrs Thomas D. Wardlaw, C.A. and Donald D. Hill, C.A.

SASKATCHEWAN

Regina Chartered Accountants Club

The annual meeting of the Regina Chartered Accountants Club was held on October 21 at the Hotel Saskatchewan. The following officers were elected for the year 1953-54: president, F. C. Copithorne, C.A.; vice-president, L. O. Robinson, C.A.; secretary, H. J. Pointer, C.A.; members of executive, C. Westerman and H. Rendall, C.A.

News of Our Members

Mr D. R. Patton, B.Com., C.A. (Que.), R.I.A., has been awarded the Coronation Medal by Her Majesty, Queen Elizabeth II, in recognition of his outstanding service in industrial and cost accounting and his continued contribution to education in the fields of accounting and business management.

Mr Ross P. Alger, C.A. (Alta.), spoke to the first meeting of the Society of Industrial and Cost Accountants of Alberta for the 1953-54 season, held in the Royal Hotel, Calgary. His topic was "Today's Challenge to the Accountant".

Mr E. H. Ambrose, C.A. (Ont.), was the

chairman of the Hamilton Red Feather campaign. He is also treasurer of the Hamilton Chamber of Commerce and very active in local welfare organizations.

Chairman of the Regina campaign was Mr H. S. Moffet, C.A. (Sask.)

Mr Philip Pugsley, C.A. (Que.), F.C.I.S., addressed the September meeting of the National Machine Accountants Association in Montreal. He spoke on "Executive Training".

Harry E. Foster Advertising Ltd., Toronto, announces the appointment of Mr D. W. Turnbull, C.A. (Ont.), as secretary-treasurer.

Accounting Research

By Gertrude Mulcahy, B.A., C.A. The C.I.C.A. Research Department

THE BALANCE SHEET - FORM & PRESENTATION

IN THE annual reports presented to the shareholders of limited companies in this country, the directors must include a "balance sheet", a statement of "income and expenditure", and a statement of "surplus". The balance sheet is a statement prepared in accordance with accounting principles, setting forth the financial position of an individual business organization at a given date.

In recent years, increasing importance has been placed on the statement of profit and loss (statement of income and expenditure) as a result of the contention that the value of an enterprise depends, for the most part, on its earning power. Although this emphasis has, perhaps, tended to belittle the balance sheet as a source of information, an intelligent reader can procure knowledge from it which is of major significance and often as equally important as that procured from the statement of profit and loss. The significance of the working capital position, of the ratio of fixed assets to funded debt and to invested capital, and of similar information, cannot be ignored in arriving at an informed opinion as to the value of an enterprise. This information can be obtained only from the balance sheet.

The Committee on Accounting and Auditing Research of the Canadian

Institute of Chartered Accountants. aware of the problem confronting accountants in the actual construction of financial statements, undertook as its first task the drafting of a statement of standards of disclosure in annual financial statements of manufacturing and mercantile companies. While these recommendations may be of assistance in determining the information which should be disclosed in respect of individual items, it is the responsibility of the executives of an enterprise to present the information in a fashion which will clearly portray the financial position of the enterprise at the balance sheet date, as well as the results of operations for the period. If care is not taken in the classification and arrangement of the various amounts, the resulting statement, while not in error in any individual item, may create an incorrect impression of the growth and financial stability of the particular enterprise. For this reason proper form and classification are essential factors in statement presentation.

Title

The words "Balance Sheet" were used in practically every case to describe the statements of assets, liabilities, and shareholders' equity included in the 1949, 1950 and 1951 reports analyzed. However six of the 1951 re-

ports used the title "Statement of Financial Position".

The title "Balance Sheet for the year ending—", which appeared in one of the 1951 reports, is unusual since a balance sheet is ordinarily considered to present the financial position as at a specified date, whereas the statement of profit and loss is ordinarily considered as presenting the results of operations for the period ending on the related balance sheet date.

Comparative Basis

The financial statements included in the annual reports should be considered as a series of annual instalments portraying the history of an enterprise. In order to understand properly the full significance of the information presented each year, a reader must be thoroughly acquainted with the story of the operations as set forth in the previous chapters of this continued story. A single set of financial statements, in itself, means little. In order to emphasize this and to make it easier for a reader to pick out the impact of current trends, some enterprises have adopted the practice of presenting the annual financial statements on a comparative basis, i.e. showing the respective amounts for the preceding year in addition to those for the year under review.

Of the financial statements which were included in the analysis for each of the three years 1949, 1950 and 1951, 24% in 1949, 30% in 1950, and 30% in 1951 were presented on a comparative basis. However, of the financial statements which were analyzed for the first time for 1951, only 25% were in comparative form.

Form and Classification

The most popular form of balance sheet in this country is that known as the "account form". This form of presentation shows the assets on one half of the statement with the liabilities and shareholders' equity on the other half (See Examples 2 and 3.) In this form, the total of the assets equals the total of the liabilities plus the shareholders' equity. Of the statements analyzed for 1949, 1950, and 1951 approximately 96% were presented in the "account form" each year.

The remaining 4% were set out in "report form". In this form of presentation, the current liabilities are deducted from the current assets to show the working capital. The other assets are added to and the other liabilities are deducted from this amount to arrive at the net assets. The shareholders' equity is then set out as a separate section and usually described as representing the net assets. (See Example 1.) It is interesting to note that in the analysis of financial statements made by the Research Department of the American Institute of Accountants, the use of this type of balance sheet has increased from approximately 7% in 1947 to approximately 14% in 1951.

For a balance sheet to be drawn up in proper form, the various items therein must be grouped with other items of a similar nature and the different groups must be properly described. Usually balance sheet items should be grouped in the following categories:

Assets

- (a) current
- (b) investments
- (c) fixed
- (d) miscellaneous
- (e) intangibles
- Liabilities (a) current
 - (b) long term

Shareholders' Equity

- (a) invested capital
- (b) surplus
- (c) reserves

Figure 1 (see below) indicates that in the vast majority of cases the balance sheet items are properly classified so that the reader does not have to undertake a recasting of the balance sheet in order to find the information he seeks.

In the balance sheets in the second category in Figure 1, the totals of the current assets were shown as separate sub-totals as was the case with current liabilities. In some instances the current assets or the current liabilities were not classified as such by an appropriate heading. In some cases a heading was set out, for say fixed assets, but apparently included under that heading were fixed assets and such items as intangibles, prepaid expenses, deferred charges and investments. In a few cases the different groups were sub-totalled, but because of improper set-up of the printed balance sheet or inadequate classification, it was difficult to recognize readily the significant figures.

Of the statements in the third category in Figure 1 all items were merely listed without descriptive headings of any kind, although sub-totals were shown, in all cases, of those assets and liabilities which would ordinarily be

classified as current assets and current liabilities.

A comparison of the balance sheets set out in examples 2 and 3 shows clearly the advantages of systematic classification and clear statement presentation.

In example 2 there has been no attempt to classify the assets and liabilities according to their respective categories, except that sub-totals have been set out for current assets and current liabilities, even though they are not described as such. In contrast, example 3 has grouped the balance sheet items in proper categories, clearly setting out the headings and totals of each type. In this case, the significant information is available with a minimum effort and with a minimum possibility of misinterpretation.

In example 3, the changes from the previous year in the various items of the balance sheet can be determined by comparison of the figures included in the statement presented whereas the reader of the balance sheet in example 2 must refer back to the statement issued the year before in order to determine the change in the financial position of the enterprise.

Figure 1			
CLASSIFICATION OF BALANCE SHEE	T ITEMS		
	1951	1950	1949
(a) Similar items grouped together under proper headings, totals, or sub-totals extended.	94%	95%	98%
(b) Dissimilar items grouped, totals or sub-totals of groups not extended, insufficient classifications.	5%	5%	2%
(c) No classification of items, only sub-totals, if any, were of current assets and current liabilities but these were			
not described as such.	1%		_
	100%	100%	100%

Example 1

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at1951 and		
	1951	1950
Cash		\$ 82,213
Accounts receivable	412,741	312,323
Inventories of wine in storage, cased goods and raw materials, valued at the lower of cost or market.	2,350,610	2,262,145
Total current assets	\$2,789,051	\$2,656,681
Less:		
Bank loan	\$ 710,872	\$
Accounts payable and accrued liabilities	84,044	79,346
Accrued federal, provincial and local taxes		198,822
Dividend payable		25,000
Serial debenture maturing within one year	200,000	200,000
Total current liabilities	\$1,207,517	\$ 503,168
Working capital	\$1,581,534	\$2,153,513
Refundable portion of excess profits tax	24,669	41,764
Deferred charges	134,581	129,021
Fixed assets, less reserve for depreciation 1951 — \$1,142,297;		
1950 — \$1,090,982	1,228,300	1,229,088
	\$2,969,084	\$3,553,386
Deduct: Serial debencures maturing after one year bearing interest 3%		200,000
interest 570		200,000
Excess of assets over liabilities	\$2,969,084	\$3,353,386
Derived from:		
Capital stock—		
5% cumulative redeemable preference shares of a par value of \$23 each: 100,000 shares (authorized and issued)	\$2,300,000	
Common stock without nominal or par value 100,000 shares (authorized 500,000 shares)	500,000	500,000
Reserve for contingencies		420,000
Earnings retained for use in the business — per statement attached	169,084	2,433,386
	\$2,969,084	\$3,353,386

Example 2

BALANCE SHEET....

ASSETS

ASSETS	
Government of Canada Securities (Market Value \$24,625.00)	\$ 25,000.00
Due from Associated Companies	
Sundry Debtors	81,634.15
Inventories of Leaf Tobacco, Manufacturing Materials and Supplies (at aver	
cost or under) and Advances for Purchases of Leaf Tobacco	
	\$6,266,293.15
Investment in Subsidiary Company:	
Shares \$ 10,000.00	
Advances (largely represented by Manufactured Goods at	
Cost and other net current Assets)	3,056,610.90
Excess Profits Tax not Currently Refundable	27,553.54
Real Estate and Buildings (at cost)	270,088.76
Plant, Machinery, Furniture and Fittings (at cost)	961,019.63
Taxes, Insurance, etc., Paid in Advance	18,030.37
Goodwill and Trade Marks	2,478.672.06
	\$13.078,268,41
	\$13,070,200.1.
LIABILITIES	
Bank Loans	
Due to Associated Companies	2,649,911.96
Sundry Creditors	182,016.29
Income and Excise Taxes	554,313.01
Dividends Payable:	
On Ordinary Shares — April 13, 1951\$75,000.00	
On 7% Cumulative Preference Shares - April 14, 1951 35,000.00	110,000.00
	4,056,149.31
Provision for Retirement Allowances to Employees	140,977.98
Reserve for Buildings, Machinery, etc.	1,240,450.98
Capital Authorized and Issued:	
7% Cumulative Preference Shares:	
20,000 Shares of the par value of \$100.00 each\$2,000,000.00	
Ordinary Shares:	
25,000 Shares of the par value of \$100.00 each	4,500,000.00
Deferred Surplus — Excess Profits Tax not Currently Refundable	27,553.54
Profit and Loss Account (Earned Surplus) Balance as per Statement herewith	3,113,136.60
and and and account (Dained outpids) Datated as per statement netewith	5,115,150.00
	\$13,078,268.41

Si

Note: The style of the original, including punctuation and capitalization, has been retained.

Example 3

BALANCE SHEET

ASSETS

	1951	1950
Current Assets:		
Cash		146,060
Government of Canada bonds — at cost		99,700
Accounts receivable, less reserve of \$59,885 in 1951 and 1950		
Refundable portion of excess profits tax		7,799
Inventory of merchandise -		
Valued at the lower of cost or market less reserve of \$200,000		
in 1951 and 1950		
Prepaid insurance	15,711	2,928
	3,625,558	3,482,665
Sundry Assets:		
Deposits with insurance underwriters	23,250	23,533
Non-marketable investment		59,225
Wholly owned subsidiary company —		
Investment in shares — at cost		
Amount due to subsidiary company 97,899		
	1	253
Fixed Assets:		
Land — at cost		
Less: Amount written off	108,130	108,130
Buildings and equipment — at cost		
Less: Amount written off 77,574		
863,089		
Less: Reserve for depreciation 696,530	166,559	146,939
\$	3,923,499	\$3,820,745

Example 3 (cont'd)

BALANCE SHEET

LIABILITIES

		1951	1950
Bank overdra	ft	325,905	
Dividends pay	vable 2 Jan 1952—		
Preferred		21,813	21,989
Common		14,833	14,833
Accounts paya	able and accrued expenses	602,189	631,562
Income and o	ther taxes payable	45,889	129,206
		1,010,629	797,590
Capital Stock, Su	orplus and Reserve:		
Capital stock	(see note)—		
Authorized-	_		
52,124 7	% cumulative preferred shares		
0	f \$100 each\$5,212,400		
74,165 c	ommon shares of \$1 each 74,165		
	\$5,286,565		

Issued and fully paid— 12,465 preferred shares	1,246,500	1,256,500
74,165 common shares	74,165	74,165
	1,320,665	1,330,665
Earned surplus —		
as per attached statement	1,509,760	1,550,821
Reserve for contingencies —		
as per attached statement	82,445	141,669
		*

\$3,923,499 \$3,820,745

3,023,155

2,912,870

Note: 100 preferred shares were redeemed and cancelled during the year as confirmed by supplementary letters patent dated 8th December 1951.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

Correspondence with the editor is cordially invited

What things explain a change in the total assets of a business over a period of time?

FOR the purpose of testing the adequacy of our accounting theory this is a most useful question to ask ourselves. We may put the question in concrete terms by looking at the very simple example below (see Figure 1).

The question now becomes, "For what possible reasons can the business assets have increased by \$3,200?" To answer the question we must picture a number

of factors operating during the year to increase assets and a number of other factors operating to reduce assets — with the final net result of an increase of \$3,200.

We submit that any net change in total assets may be explained under three headings:

- The net final effect upon total assets of transactions between the business and its creditors;
- (2) The net final effect upon total assets of transactions between the business and its proprietor; and

Figure 1		
THE JONES CEMENT COMP	ANY	
TOTAL BUSINESS ASSETS	S	
	as at 31	Dec.
	1952	1953
Money	\$ 850	\$ 1,100
Accounts receivable	3,630	6,400
Merchandise, at cost	3,720	2,000
Building, at cost less depreciation	5,000	4,900
Equipment, at cost (acquired Dec. 1953)		2,000
Total business assets	\$13,200	\$16,400
		13,200
Net increase in total business assets		\$ 3,200

Figure 2 THE JONES CEMENT COMPANY NET CHANGE IN BUSINESS DEBTS for the year ended 31 Dec 1953 as at 31 Dec. 1953 \$ 500 Accounts payable 2,200 2,800 Mortgage on building 2,500 2,200 Total business debts\$ 4,700 5,500 4,70C Net increase in total assets attributable to transactions with creditors \$ 800

(3) The net final effect upon total assets of transactions between the business and its customers (profit or loss for the year).

. . . .

One result of this sort of analysis is that it forces us to look at the creditors of a business from a point of view which is helpful in understanding business finance generally. Creditors are a source of assets. During a business year creditors provide a business with assets by supplying money, goods, and services without the requirement of immediate payment (or repayment, as the case may be). On the other hand the payment of creditors' claims as they come due during a year results in a reduction in total assets (specifically, in money). Looked at in this way we may say that if during a year the creditors of a business have provided it with a greater dollar amount of assets than has been required to pay their claims, the creditors' claims (i.e. the business debts) must be greater at the end of the year than at the beginning. Conversely, if the assets (money) used to pay the creditors during the year have exceeded the various assets received from creditors, the creditors' claims must have been reduced over the year. And so we

may determine the net final effect of transactions between a business and its creditors by comparing the business debts at the beginning and end of the year (see figure 2).

In the same way we may look at the transactions between the business and its proprietor as possibly adding to business assets during the year, and also as reducing business assets during the year. A summary of such transactions might be as shown in figure 3. (See p. 317)

For the purpose of explaining profit (or loss) we should, as with the other types of transactions, think of the transactions between a business and its customers as both adding to, and reducing business assets during the year; with the net final result that the assets received from customers are greater (or less) in the aggregate than those sold to customers. The assets received from customers are of course money and accounts receivable; the assets sold to customers are the merchandise and services the business has purchased in the course of its operations. It follows that the essence of income (profit or loss) is an exchange of assets.

Figure 3 THE JONES CEMENT COMPANY

SUMMARY OF TRANSACTIONS BETWEEN THE PROPRIETOR AND HIS BUSINESS for the year ended 31 Dec 1953

Withdrawals of money and merchandise by the proprietor
for personal purposes during the year\$3,000
Additional capital invested by the proprietor during the year
Net decrease in total assets attributable to transactions
between the proprietor and his business\$2,000

From all the information appearing in Figures 1, 2, and 3 we may infer the amount of profit for the year as shown in Figure 4. It will be the residual explanation of the net change in total assets.

It is worth noting that the "increase in total business assets attributable to transactions between the business and its customers" is a measure of the effectiveness of past purchasing decisions as well as of current selling activities. The benefits of wise purchasing are not recognized in the measurement of income until the goods and services purchased have been sold to customers.

If we may end our little story with a

moral, as is the popular custom, it is that the measurement of income is based upon a comparison of assets at the beginnning and end of the year. The real accounting problem is to translate all the assets into dollar figures. Put another way, then, the proposition (or moral) is that the figure of income is directly affected by the methods of assigning dollar figures to the various assets. And this proposition is as valid for a business using a double entry system as for a business using the single entry method. It is for this reason that we have such earnest discussions in our accounting magazines about the appropriate methods of "valuing" inventories and fixed assets.

Figure 4 THE JONES CEMENT COMPANY

\$3,200
800
2,400
2,000
\$4,400

CORRESPONDENCE

Toronto, Ont.

Sir: In the October issue of *The Canadian Chartered Accountant* the solution for the final examination accounting II, Question 8 shows a claim being made for \$37,920 capital cost allowance whereas \$25,600 was written in the accounts.

I do not believe that you can claim more than is recorded in the accounts.

J. D. P.

Editor's reply: In our opinion the solution may be justified by the Income Tax Regulations, Part XI, s. 1100(4). This section contains the only restriction on capital cost allowance and begins, "Where the taxpayer is a corporation resident in Canada. . . ." The calculation of taxable income in the solution is for a period in which the business was unincorporated. This exclusion of unincorporated businesses from the restriction is a fundamental change from the former Income War Tax Act in which the regulations were as you state in your letter.

Rejoinder to Mr. Gray's Letter in the August Issue

Toronto, Ont.

Sir: Mr. Gray has offered a number of criticisms of the solution to Problem 2 in The Students' Department for August with which I am unable to agree.

In my opinion, the par value of the shares issued to D and his wife should not enter into the question because section 67(3) of the consolidated statute requires the apportionment of the profit for the year to be on the basis of assets contributed. Section 22(1) requires that any gift or transfer of shares to the son shall also be disregarded since he is under 19.

Secondly, I suggest that the sale by the wife of any of her shares to the husband need not be considered because section 21(1) excludes any such transfers from having an effect on the apportionment of profits for the year.

Mr. Gray's third point about the possibility of balances standing at the debit or credit of the shareholders' personal accounts may well be valid, but since it is not referred to in the question in any way it seems to me that he is writing into the question an unnecessary difficulty.

I do, however, find myself in agreement with the point Mr. Gray raises in his final paragraph. While section 4 of the Income Tax Act states that the income from a business or property is the profit therefrom for the year I think the problem might better have referred to the \$35,000 as "income".

TORONTO C.A.
Toronto, Ont.

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Sir: I would like to dispute a point made by E. Stamp in his article "An Algebraic Approach to Double Entry" in the October issue of *The Canadian Chartered Accountant*. In his analysis of debits and credits he remarked, "this is all there is to Dr. and Cr. and their association with the words debtor and creditor is unfortunate and, except in rare cases, quite irrelevant". I am forced to disagree with this conclusion and as you will see in the following example, the relationships of the debtor and debits, and creditors and credits are very important to a basic understanding of accounting theory.

In this example, we are the owners of a business.

A debtor may be defined as a person, or business, who owes us money or services. J. Brown is a person who purchased \$500.00 worth of merchandise from us on credit. He is a "debtor" and therefore in the accounts receivable we "debis" his account for \$500.00.

A creditor may be defined as a person to whom we owe money. If we purchase \$600.00 worth of furniture from B. Smith on credit, we owe him \$600.00. He is a "creditor" and therefore we "credit" his account in the accounts payable for \$600.00.

A proprietor is also a "creditor" of the business and his equity is a "credit" balance. We can conclude then, that where there is a creditor there is a credit entry, and where there is a debtor, there is a debit entry.

I can hardly see, then, how a principle which affects over half the balance sheet, viz., liabilities, proprietorship and accounts and bills receivable is "unfortunate and quite irrelevant".

> IRVING ROSEN (1st year student B. Pape & Co., Toronto.)

Rejoinder to Mr. Rosen's Letter

Toronto, Ont.

Sir: In attempting to warn the reader against oversimplification I have been guilty of exaggeration myself. I can only justify this by pointing our that although a bookkeeper is concerned with numerous entries of the type Mr. Rosen describes, the accountant is more often occupied with more complex entries.

Furthermore, it would take a remarkable and wasted feat of mental gymnastics to reconcile entries of the following type with the ideas of debtor and creditor:

Dr. Wages

Cr. Cash for wages paid

Dr. Cost of sales

Cr. Inventory for inventory shortage

Dr. Depreciation of building

Cr. Allowance for depreciation

for annual depreciation

and all these entries affect the balance sheet position.

It should also be noted that shareholders, i.e. proprietors, are not creditors except as regards dividends declared.

E. STAMP

THE AUDITOR EXPLAINS TO THE CLIENT

(Submitted by a C.A. in Kingston, Ontario)

- C. So your statement shows we made \$50,000 last year. I don't believe it. Where's the money?
- A. Well, of course, you spent \$40,000 on that new machinery, and you have \$25,000 more tied up in your inventories than you had a year ago.
- C. Oh, I see. But wait a minute, that makes \$15,000 more than our profit, and I know we haven't borrowed any money.
- A. That's right, but you did write off \$25,000 of depreciation.
- C. What's that got to do with it?
- A. In a nutshell, the \$25,000 charged for depreciation was recovered from your customers last year, in addition to the \$50,-
- C. Sure, but we have a depreciation reserve haven't we?
- A. Yes, \$110,000.
- C. Well, how can we have the reserve and use it at the same time? By the way, shouldn't we invest our depreciation reserve in something good?

- A. Hold on a minute. That depreciation reserve isn't cash, you know.
- C. But you just said we get it out of the customers.
- A. True, but you have already put most of it to work again.
- C. Oh, you mean we used it to buy that new machinery last year?
- A. You could look on it that way.
- C. Well then, where has the profit gone?
- A. This is getting a bit complicated. You see, this has been going on for a good many years — buying long term assets, depreciating them, replacing them and at the same time expanding the business by buying additional plant and equipment.
- C. Then if we weren't expanding, we would have the depreciation reserves in cash?
- A. Not exactly, because from time to time you replace worn out assets, and these cost more to-day than the original assets cost. Also, part of the money has been put into expanded inventories and receivables.

- C. All we have to do, then, is to write off more depreciation on the old assets, to get enough money from the customers to pay for new ones. Be careful, now — I think I have you in a corner.
- A. I'm not going to suggest that you will get more for your produce merely because you charge more for depreciation; but if you did base your depreciation charge on present replacement costs rather than original costs, your profits would be lower and your taxes would be reduced — if the Tax Department would accept the figures. Of course, the rates allowed by the Tax Department as capital cost allowances are high enough to cover replacement cost depreciation on relatively new assets, but not on old stuff.
- C. Can we charge this capital cost allowance as well as depreciation?
- A. Not a chance.
- C. I just thought I might mention it. To

- come back to these reserves, why do you call them reserves if they aren't? Here's a reserve for income tax I suppose we haven't got that either?
- A. That reserve is merely a liability, like accounts payable. It is big, but I think you will be able to meet it. You are right, though, about calling these different things reserves. Let's say it's just a bad habit that accountants have got into. We are trying to break it now, and I'll be glad to change the wording to something more intelligible.
- C. Such as?
- A. Accumulated allowance for depreciation, allowance for doubtful accounts, estimated liability for income taxes — some phrase that will describe each item.
- C. Why of course, go ahead. Maybe then I can start to understand my own statements. Why didn't you do this long ago?
- A. What a life!

LAST PUZZLE FOR 1953

ANACROSTICS

The finished anacrostic is a quotation which is written into the diagram, and reads from left to right (there is no "down" as there is in crossword puzzles).

How to go about solving:

- 1. Fill in as many of the words as you can, using the clues alongside.
- Transfer each letter from the words to the diagram, following the indicated numbers.
- 3. Where applicable, transfer letters from the diagram to the source.
- Now comes the interesting part, work all four (clues, words, diagram, and source) wherever you see an opening.

This is probably "the" so fill in the "E" and transfer it first to the diagram, then to the words.

Suppose that gives you $\frac{\mathbf{F}}{9} = \frac{\mathbf{F}}{6} = \frac{\mathbf{T}}{13}$ in the words, which could be "feat" or

"feet". Look at the clue and see which is more likely, and so on.

The fun and skill of the anacrostic lies in weaving backwards and forwards between clues, words, diagram, and source.

CLUES

WORDS

i. An extra piece of paper attached to a document to provide space for A endorsement when no space is left ---for this purpose on the document 4 25 26 35 28 itself

ii. Watch your step

iii. The first part is spelt as you do, The second as you don't; The whole? You don't say!

iv. Procrastinate

v. Sounds to me like "crazy loot" but P Y C C apparently economists call it this ----

vi. Fifo and lifo have a new little brother

vii. To the accountant this is the op- C posite of something, whereas his — — wife thinks of them as being the 11 47 55 69 same

viii. The squealer's rake-off

ix. To distribute in portions

x. Sign of agreement

xi. Heavy, light, comic, soap, or (this) -----

xii. Help

xiii. How much?

20 23 10 7 4

Quotation:-

		1	xvi	2	xiv	3	ii			4	i	5	v	6	vi	7	·v		
8	v	9	ii			10	xii	11	vii	12	xii	13	iv	14	ii				
15	ii	16	xvii	17	iv			18	xvi	19	xi	20	ii	21	iv	22	xiii		
23	iii	24	vi			25	i	26	i	27	vi	28	i			29	xvii	30	ix
31	ix	32	ii	33	xiv	34	ii	35	i			36	xiv	37	х	38	xiii		
39	viii	40	х	41	xvi	42	х	43	ix			44	xi	45	v				
46	xi	47	vii	48	xvii	49	xv			50	iii	51	xi						
52	xii	53	v	54	ii	55	vii	56	ii			57	ix	58	х	59	х		
60	ii	61	viii	62	v	63	xiii	64	jii	65	iv	66	х	67	viii	68	χv	69	vii

12 21

6 51 61 31 52

(Puzzle on anacrostics submitted by Mr. R. C. Kingsley, Kelowna, B.C.)

SOLUTION TO THE NOVEMBER PUZZLE

Let Tom's share be x acres.

Then Harry's share is (1,000 - x) acres.

Hence
$$\frac{4x}{3}$$
 + $\frac{4}{5}$ (1,000-x) = 1,000

i.e. x = 375.

Tom receives 375 acres; Harry, 625 acres.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1952

Accounting II, Question 6 (15 marks)

For each of the following procedures (a) suggest why it might be adopted by a concern and (b) set out the reasons for or against its adoption.

- (i) Addition of a fixed percentage to expenditures on additions to fixed assets, whether executed by outside contractors or by the concern itself, to cover overhead expense.
- (ii) Reduction of inventory valuations by 10% of cost.
- (iii) Deliberate postponement of the shipment and invoicing of merchandise ordered by customers near the end of an abnormally profitable fiscal year.

A SOLUTION

(i) Reasons why procedure might be adopted

- On the reasoning that since overhead is an element of the cost of manufacturing goods held for sale it should also be considered a cost of fixed assets manufactured, and hence should also be considered a cost of fixed assets built by outsiders.
- 2. To understate expenses of the year of acquisition.

Reasons for or against its adoption

- For fixed assets constructed it is proper to add to cost the variable overhead incurred by reason of the construction. Most accountants would not, however, include fixed overhead on the grounds that this treatment would lead to an over-statement of profit for the year.
- It is not accepted accounting practice to increase the cost of assets acquired from outsiders by any portion of overhead cost which cannot logically be shown to be a direct result of the acquisition of the assets.

(ii) Reasons why procedure might be adopted

- 1. To be conservative.
- 2. To provide, in effect, an inventory reserve against a future decline in prices.
- 3. To reduce inventory to "market".

Reasons for or against its adoption

324 The Canadian Chartered Accountant, December, 1953

- The procedure is in order only if the inventory is to be recorded at "the lower of cost or market" and "market" happens to be 10% below cost.
- 2. Apart from the possibility just mentioned, the practice understates profit for the year of its adoption and for any subsequent year in which the inventory volume increases. It overstates the profit for any year in which the inventory quantities decline. It is not a "generally accepted" basis of valuation.
- 3. The practice results in an understatement of inventory for balance sheet purposes.

(iii) Reasons why procedure might be adopted

To keep down reported profit and tax for the year, presumably on the assumption that the profit or tax for the next year may not be as high.

Reasons for or against its adoption

The objections to the procedure are on grounds of general fiscal policy. It is
in effect a means of levelling profits from year to year without making any
improper entries, as such, in the accounts.

EXAMINER'S COMMENTS

A number of students misinterpreted the requirements by questioning the validity of adding a fixed percentage to the cost of the new assets instead of adding a portion of the actual (or estimated) overhead to the fixed asset additions.

PROBLEM 2

Final Examination, October 1952

Accounting III, Question 2 (25 marks)

In order to realize certain economies it was decided that the operations of two similar manufacturing concerns should be amalgamated. The balance sheets of the two concerns as at 31 Dec 1951 were as follows:

concerns as at 31 Dec 1931 were as follows:		
	XY Bros.	Z Co. Ltd.
ASSETS		
Current assets		
Cash on hand and in bank	\$ 12,000	\$ 20,000
Investment in A Co. Ltd. bonds	6,000	***********
Accounts receivable less reserves	60,000	75,000
Inventories	165,000	190,000
Prepaid expenses and accrued revenue	1,000	1,200
Refundable portion of excess profits tax		12,000
	\$244,000	\$298,200
Fixed assets	\$320,000	\$400,000
Less accumulated depreciation	112,000	210,000
	\$208,000	\$190,000
Goodwill	\$	\$ 50,000
	\$452,000	\$538,200

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ve

LIABILITIES

Current	liabilities
---------	-------------

Current liabilities		
Accounts payable and accrued expenses	\$ 40,000	\$ 30,000
Taxes on income	*********	28,000
	\$ 40,000	\$ 58,000
Capital		
Capital stock	\$	\$400,000
Surplus	*********	80,200
X capital account	140,500	
Y capital account	271,500	
	\$412,000	\$480,200
	\$452,000	\$538,200

On 3 Jan 1952 a syndicate agreed to purchase the net assets of the two concerns on the following basis:

XY Bros.

- (a) All assets at book values, less current liabilities, with the following exceptions:
 - (i) Obsolete parts included in the inventory at \$18,000 are to be omitted from the purchase agreement.
 - (ii) The investment in A Co. Ltd. bonds, on which accrued interest of \$300 is included in the accrued revenue, is to be omitted together with such accrued interest.
 - (iii) A loan from Y of \$10,000, included in the accounts payable is not to be assumed by the syndicate.
- (b) The consideration for the remaining net assets to be \$399,000 payable as detailed below by shares of a new company, B Co. Ltd., which is to be formed.
- Z Co. Ltd.
- (a) All assets at book values, less current liabilities, with the following exceptions:
 - (i) The refundable portion of excess profits tax is to be omitted as this is not assignable.
 - (ii) The asset goodwill is omitted from the agreement.
- (b) The consideration for the remaining net assets to be \$500,000 payable, as detailed below, by shares of the new company, B Co. Ltd.

In each case it was agreed that preferred shares in B Co. Ltd. of a par value equal to the net book value of fixed assets would be given, and the balance of the consideration would be settled by the transfer of preferred and common shares in B Co. Ltd in the proportion of one preferred share for each four common shares.

In accordance with the requirements of the agreements the B Co. Ltd. was formed on 3 Jan 1952 with an authorized capital of \$2,000,000 divided into 10,000 5% preference shares of \$100 par value each and 10,000 common shares of \$100 par value each.

The B Co. Ltd. agreed to purchase from the syndicate the net assets of XY Bros. and Z Co. Ltd. which the syndicate then held, the purchase to be effective as of 4 Jan 1952. The valuations agreed upon were book values as shown on the balance sheets of the vendor concerns at 31 Dec 1951 except for fixed assets which were to be valued as follows:

Z. Co. Ltd.	360	000

The consideration for the purchase was \$1,400,000 payable by the issue of 7,000 preference shares and 7,000 common shares, all fully paid.

The following information is also available:

Re XY Bros.

- (i) The obsolete parts were sold as scrap for \$800
- (ii) The bonds of A Co. Ltd. and the accrued interest were distributed to the partners on winding up of the partnership, in their profit sharing ratio
- (iii) Profits and losses are shared in the proportions X 1/3, Y 2/3.

Re Z Co. Ltd.

(a)

The refundable portion of excess profits tax was received 31 Mar 1952. Required:

- (a) Journal entries, without narratives, to close the books of XY Bros. (showing distribution of the assets to the partners individually).
- (b) Journal entries, without narratives, to close the books of Z Co. Ltd.
- (c) Balance sheet of the B Co. Ltd. after giving effect to the purchase.

A SOLUTION BOOKS OF XY BROS.

Realization account Cash on hand and in bank Accounts receivable less reserve Inventory Prepaid expenses and accrued revenue Fixed assets To close out to realization account the assets sold to Syndicate in accordance with terms of agreement.	539,700	12,000 60,000 147,000 700 320,000
Reserve for depreciation Accounts payable and accrued expenses Realization account To close out reserve for depreciation and liabilities assumed per agreement.	112,000 30,000	142,000
Syndicate Realization account Consideration for sale of assets	399,000	399,000
Shares in B Co. Ltd. Syndicate Receipt of shares as consideration for sale 1528 Common Shares — \$100 par value 2462 Preferred Shares — \$100 par value.	399,000	399,000
Realization account Cash Inventory Disposal of balance of inventory for cash.	17,200 800	18,000
Accounts payable Y Capital account To transfer loan on capital account.	10,000	10,000

The Students' Department

327

X Capital account	5,300	
Y Capital account	10,600	
Realization account		15,900
To transfer loss on realization of assets.		
X Capital account	135,200	
Bonds, A Co. Ltd.		2,000
Accrued interest		100
Shares, B. Co. Ltd. (509 Common, 821 preferred)		133,000
Cash		100
Distribution of assets to X on dissolution.		
Y Capital account	270,900	
Bonds, A Co. Ltd.	270,700	4,000
Accrued interest		200
Shares, B Co. Ltd. (1,019 Common, 1,641 preferred)		266,000
Cash		700
Distribution of assets to Y on dissolution.		
-		
(b) BOOKS OF Z CO. LTD.		
Realization account	736,200	
Cash on hand and in bank		20,000
Accounts receivable less reserve		75,000
Inventory		190,000
Prepaid expenses and accrued revenue		1,200
Fixed assets		400,000
Goodwill		50,000
To close out assets sold to Syndicate in accordance		
with agreement, and also goodwill.		
Reserve for depreciation	210,000	
Accounts payable and accrued expenses	30,000	
Taxes on income	28,000	
Realization account		268,000
To close out reserve for depreciation and liabilities assumed.		
Syndicate	500.000	
Realization account	500,000	500.000
To set up amount of consideration for sale of net assets.		500,000
Shares in B. Company Ltd.	500,000	
Syndicate		500,000
Receipt of consideration as per agreement, 2,480 common shares		
and 2,520 preferred shares.		
Realization account	31,800	
Surplus	21,000	31,800
To transfer profit on disposal of assets.		24000

328 The Canadian Chartered Accountant, December, 1953

Cash		
Refundable portion of	excess profits tax	12,000
To record receipt of refu	ndable portion.	
Surplus		
Capital stock	400,000	
	unionamental and an antique and an antique and an antique and	12,000
		500,000
To record distribution of a	ssets to shareholders on winding up.	
(c)	B COMPANY LIMITED	
1-7	BALANCE SHEET	
	4 January 1952	
	ASSETS	
6	ASSETS	
Current assets	1 22 222	
	nk \$ 32,000	
	ss reserve	
	337,000	\$505,900
rrepaid expenses and a	ccrued revenue 1,900	\$ 202,900
Fixed assets, at cost		700,000
Goodwill		282,100
		\$1,488,000
	LIABILITIES	
Current Liabilities		
Accounts payable and a	ccrued expenses \$ 60,000	
Taxes on income	28,000	\$ 88,000
Capital stock		

Authorized:

10,000 5% preference shares of \$100 par value each

10,000 common shares of \$100 par value each

Issued:

7,000 preference shares 700,000

\$1,488,000

EXAMINER'S COMMENTS

Some candidates did not read part (a) of the question and so did not show the distribution of the assets to the partners individually.

